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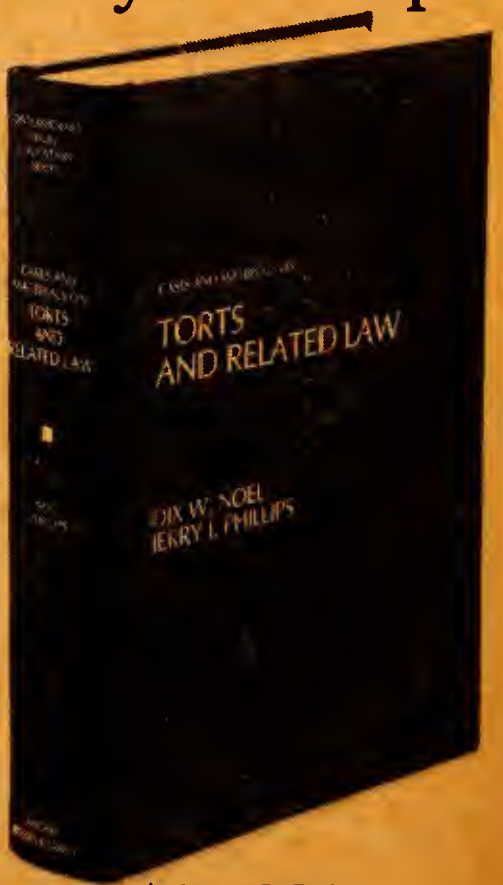


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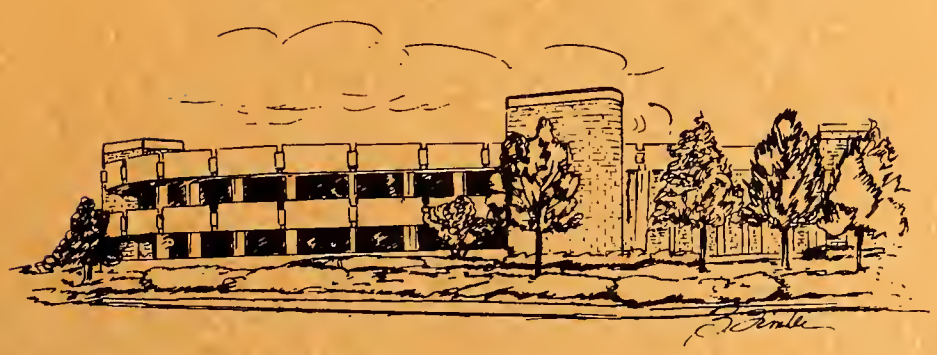

## Article



## Notes

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## Article



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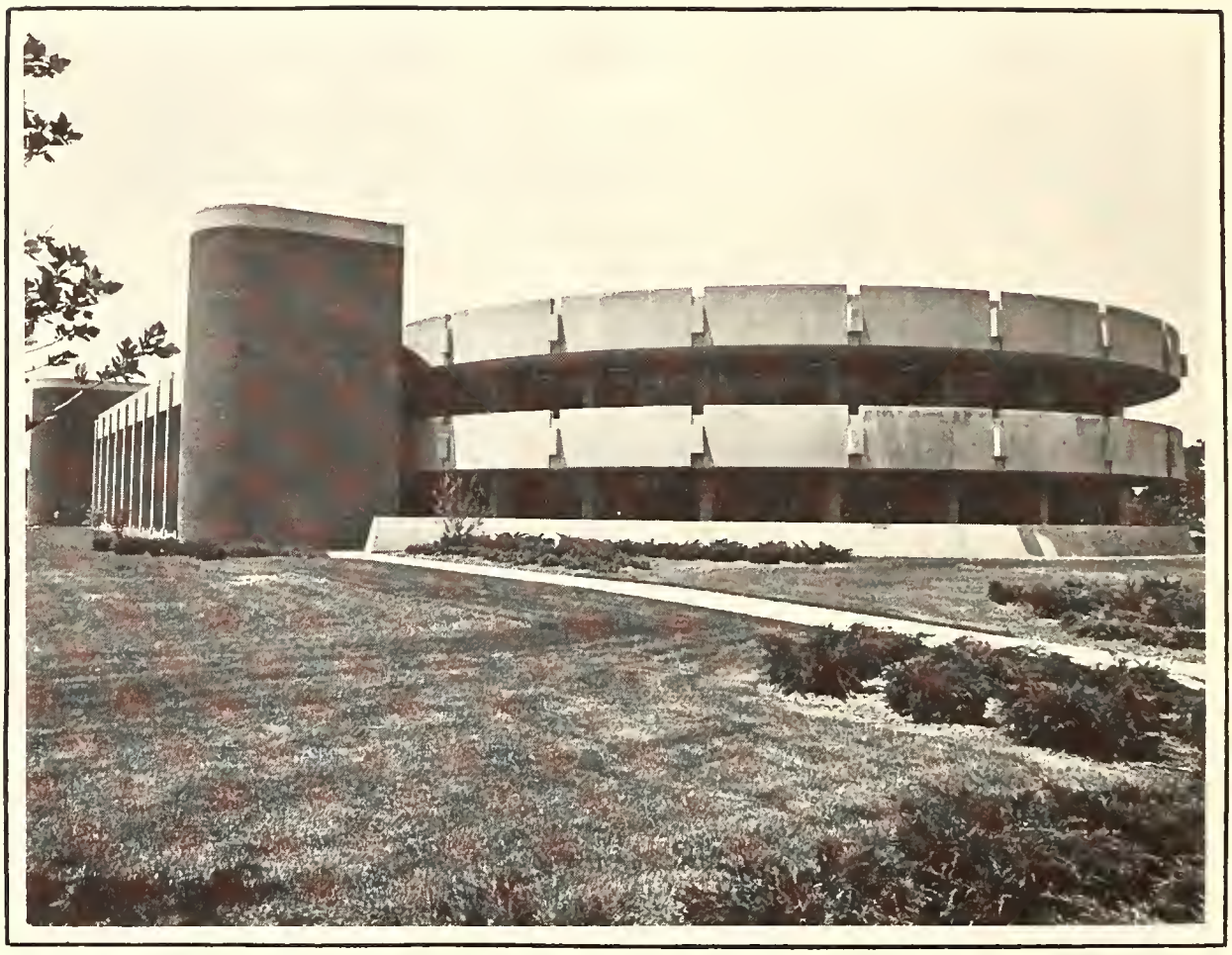

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## ERRATA

p. 278 "read" should be "recite"
p. 289 fn 238 "12200" should be "12-200"

Indiana Law Review

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# Prospective Labor Injunctions: Do They Have a Future?

CHARLES E. TRANT*

## I. INTRODUCTION

The employment relationship is rarely, if ever, a static entity. Rather, it is a continuing reevaluation by both parties of their respective positions to insure that their interests are satisfied. Therefore, labor disputes are inevitable, although not necessarily undesirable, so long as the bargaining strength of each party keeps excesses by the other in check. In these disputes the most potent weapon in the union arsenal is the strike or the threat of strike, both of which require a highly fluid situation in which the ability to build economic pressure and adjust stategies is the key to victory.

An employer's success depends upon his ability to defuse the fluid situation and freeze the "status quo." Traditionally, employers have relied upon theories such as criminal and civil conspiracy, nuisance, and interference with advantageous relationships. More recently, the injunction has become the most prevalent device, as well as the singularly most effective method of killing a strike.

Because a prospective injunction magnifies the employer's bargaining strength, policy considerations must be balanced in determining if and to what extent an injunction will be allowed. The prospective injunction must be viewed from the historical perspective of the ordinary injunction. The latter underwent a period of widespread use and resultant abuse, which prompted a period of legislative action engendered by public discontent to perceived judicial excesses. Initially, anti-trust legislation was enacted, however, because of subsequent judicial emasculation, specific labor legislation was later enacted.

The courts have been involved in an ongoing attempt to accommodate these legislative acts when apparent conflicts arise. Such a conflict exists between the anti-injunction posture of the Norris-LaGuardia Act and the presumption of favorability accorded arbitration and injunctive relief under the Taft-Hartley Act. The use of the

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prospective injunction in this accommodation process ultimately revolves around policy considerations of its social desirability, its potential uses and abuses.

## II. Historical Perspective

The labor injunction is so inextricably intertwined with the socio-political-economic climate of the times, that an understanding of its origin and development is essential in determining its desirability. Injunctions are an integral part of our labor laws, laws which are rooted in the English experience.[1] The ability of laborers to challenge the economic superiority of employers in England became a dilemma of major proportions in 1348 when the available work force was drastically reduced by the ravages of the Black Plague. To prevent the sought after employees from controlling the terms of their employment and to preclude interference with the employment relationship, Parliament enacted The Statute of Laborers[2] and A Statute of Laborers.[3] In succeeding years additional laws were passed, culminating in a comprehensive labor code, the Elizabethan Statute of Laborers.[4]

### *A. Criminal Conspiracy*

The laborers' attempts to improve their conditions of employment, notwithstanding these restrictive laws, gave rise to the theory of concerted activity as criminal conspiracy. This theory was clearly enunciated in *Rex v. Journeymen-Taylors of Cambridge*,[5] in which the court found concerted demands by the journeymen tailors for higher wages to be an unlawful conspiracy. This concept was readily assimilated into the American experience as evidenced by the famous *Philadelphia Cordewainers* case decided in 1806.[6] In that case, the leaders of the strike were convicted of criminal conspiracy and the union was effectively destroyed.[7]

A series of indictments and convictions occurred over the three

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[1]*See generally*, R. HEDGES & A. WINTERBOTTOM, THE LEGAL HISTORY OF TRADE UNIONISM (1930).

[2]The Statute of Laborers, 1349, 22 Edw. 3, c.1-8.

[3]A Statute of Laborers, 1350, 25 Edw. 3, c.1-7.

[4]Elizabethan Statute of Laborers, 1562, 5 Eliz. c.4.

[5]88 Eng. Rep. 9 (K.B. 1721).

[6]Commonwealth v. Pullis (Mayor's Court of Philadelphia, 1806), *reprinted in* 3 THE DOCUMENTARY HISTORY OF AMERICAN INDUSTRIAL SOCIETY 59-248 (J. Commons & E. Gilmore eds. 1910). These records include the entire testimony and proceedings in several of the early unreported labor cases in inferior courts.

[7]The court reasoned, "A combination of workmen to raise their wages may be considered in a two fold point of view: one is to benefit themselves . . . the other is to injure those who do not join their society. The rule of law condemns both." Commonwealth v. Pullis (Mayor's Court of Philadelphia, 1806), *reprinted in* 3 THE DOCUMEN-

decades which followed *Philadelphia Cordewainers*.[8] The basis of these convictions was succinctly illustrated in *People v. Melvin*,[9] in which the court noted that conspiracy is the gist of the charges; and even to do a thing which is lawful in itself, by conspiracy is unlawful.[10]

Fortunately, equating a labor organization with a criminal conspiracy was permanently arrested in *Commonwealth v. Hunt*.[11] The court in *Hunt* held that the purpose of labor organizations was not unlawful and thus "the legality of such an association will therefore depend upon the means to be used for its accomplishment."[12] The emphasis thus shifted from the justifiable objectives of the labor association to its tactics.[13]

### *B. Civil Theories*

Employers were also active in the civil courts, basing their claims on such common law theories as nuisance, trespass, and tortious interference with advantageous relationships.[14] Again, drawing sustenance from the English traditions, American civil courts were receptive to restraints on concerted activity.[15] The courts utilized an "objectives" test to determine the validity of the concerted activity. Because union demands necessarily curtail the employer's private property interests, the courts held that any intentional infliction of

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TARY HISTORY OF AMERICAN INDUSTRIAL SOCIETY 233 (J. Commons & E. Gilmore eds. 1910).

[8]*See, e.g.*, People v. Fisher, 14 Wend. 9 (N.Y. Sup. Ct. 1835). *See generally* Witte, *Early American Labor Cases*, 35 YALE L.J. 825 (1926).

[9]2 Wheel. Cr. Cas. 263 (Crim. Ct. N.Y. 1810).

[10]*Id.* at 279-80.

[11]45 Mass. (4 Met.) 111 (1842).

[12]Labor associations were no longer subject to criminal conspiracy charges in England by act of Parliament in 1875. The Conspiracy, and Protection of Property Act, 1875, 38 & 39 Vict., ch. 86, § 3.

[13]Thus, although criminal conspiracy charges continued to exist into the 1880s, it was not as easy to establish "means," as it was merely to prove "purpose." This caused such charges to simply fall into disuse.

[14]In Lumley v. Gye, 118 Eng. Rep. 749, 755 (Q.B. 1853) (Erle, J.) the court stated:

> The authorities are numerous and uniform, that an action will lie by a master against a person who procures that a servant should unlawfully leave his service. The principle involved in these cases comprises the present; for, there, the right of action in the master arises from the wrongful act of the defendant in procuring that the person hired should break his contract, by putting an end to the relation of employer and employed; and the present case is the same.

*See also* South Wales Miners' Fed'n v. Glamorgan Coal Co. [1095] A.C. 239.

[15]With the demise of the criminal conspiracy concept, the English were invoking a concept of civil conspiracy which precluded a combination of workers to injure their employers without justifiable objectives. *See, e.g.*, Quinn v. Leathem, [1901] A.C. 495. This practice ended with the Trade Disputes Act, 1906, 6 Edw. 7, c.47.

temporal damage to those interests required justification. The union had to win immunity for its actions through its purpose. Certain objectives of concerted action, such as higher wages, were of a direct and obvious benefit to the workers and were therefore protected.[16] However, the step across some nebulous line to an area where the objectives could be subjected to dispute was not far.[17] Because unions had their objectives[18] subjected to the personal philosophies and predilections of judges, results were often illusory, ambiguous, and contradictory.[19] The conservative nature of the judiciary resulted in the repressive use of injunctions against unions, depriving them of their most valuable economic weapon, the strike.[20]

Despite intervening legislation[21] which afforded employers additional avenues of attack, the vitality of the "objectives" test, cir-

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[16]F. FRANKFURTER & N. GREENE, THE LABOR INJUNCTION (1930):

> Self-interest, in its undefined amplitude is the end that justifies. But of the innumerable ways in which self-interest may be asserted, only those grant immunity which have "a direct relation to benefits that laborers are trying to obtain." Obviously this is a test implying judgment on economic and social data; yet it is treated as "a question of law to be decided by the court."

*Id.* at 27 (quoting respectively Folsom v. Lewis, 208 Mass. 336, 338, 94 N.E. 316, 317 (1911) and DeMinico v. Craig, 207 Mass. 593, 598, 94 N.E. 317, 319 (1911)).

[17]One degree more remote and the courts could vary. *See, e.g.*, Mechanics' Foundry & Mach. Co. v. Lynch, 236 Mass. 504, 128 N.E. 877 (1920) (seeking the reinstatement of a discharged employee was *not* a protected objective).

[18]If a number of objectives were involved, it was only necessary for one objective to be illegal to render the union activity illegal. *See* Folsom v. Lewis, 208 Mass. 336, 94 N.E. 316 (1911).

[19]C. GREGORY, LABOR AND THE LAW (2d Rev. Ed., 1961).

[20]*See* Cox, *The Role of Law in Labor Disputes*, 39 CORNELL L.Q. 592 (1954). Illustrative of judicial thought during this era is the classic case of Vegelahn v. Guntner, 167 Mass. 92, 44 N.E. 1077 (1896), wherein the court stated:

> A combination among persons merely to regulate their own conduct is within allowable competition, and is lawful, although others may be indirectly affected thereby. But a combination to do injurious acts expressly directed to another, by way of intimidation or constraint, either of himself or of persons employed or seeking to be employed by him, is outside of allowable competition, and is unlawful.

*Id.* at 98-99, 44 N.E. at 1077-78. This theory was later overturned by Congress's enactment of the Norris-LaGuardia Act. *See* notes 60, 66-67 *infra*. In dissent, Justice Holmes would have allowed intentional infliction of temporary damage to the employer (absent violence) to balance the economic realities of the parties. *Id.* at 104-09, 44 N.E. at 1079-82 (Holmes, J., dissenting). *See also* Plant v. Woods, 176 Mass. 492, 504-05, 57 N.E. 1011, 1015-16 (1900) (similar dissent by Holmes); Holmes, *Privilege, Malice and Intent*, 8 HARV. L. REV. 1 (1894).

[21]Sherman Anti-Trust Act of July 2, 1890, ch. 647, 26 Stat. 209 (1934) (current version at 15 U.S.C. §§ 1-7 (1976)) [hereinafter cited as the Sherman Act]; Clayton Anti-Trust Act, Pub. L. No. 212, ch. 323, 38 Stat. 730, 731, 736-40 (1914) (current version at 15 U.S.C. §§ 12-27 (1976)) [hereinafter cited as the Clayton Act]. *See* notes 25 & 42 *infra* and accompanying text.

cumscribed narrowly by an anti-union judicial tenor, survived virtually unabated into the twentieth century.[22] The Supreme Court of the United States reiterated the test in the highly criticized opinion of *Hitchman Coal & Coke Co. v. Mitchell*.[23] The Court held:

> [A]ny violation of plaintiff's legal rights contrived by the defendants for the purpose of inflicting damage, or having that as its necessary effect, is as plainly inhibited by the law as if it involved a breach of the peace. A combination to procure concerted breaches of contract by plaintiff's employees constitutes such a violation.[24]

## III. Anti-Trust Legislation

### *A. Sherman Act*

During the same period that the civil conspiracy injunctions and the "objectives" test were at the height of their popularity, big business was expanding and amassing tremendous economic power. The abuses which resulted created a storm of public indignation that prompted Congress to pass the Sherman Anti-Trust Act.[25] The principal thrust of the Act was to protect trade and commerce against unlawful restraints and monopolies.[26] However, employers latched onto the general language of the Act[27] and utilized it as another vehicle to enjoin labor organizations.[28] The catalyst for employers utilizing the Sherman Act was *In re Debs*,[29] in which the Court upheld federal intervention in breaking the Pullman Strike.[30]

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[22]*E.g.*, American Steel Foundries v. Tri-City Cent. Trades Council, 257 U.S. 184 (1921); Coppage v. Kansas, 236 U.S. 1 (1915).

[23]245 U.S. 229 (1917).

[24]*Id.* at 257. *See also* Adair v. United States, 208 U.S. 161 (1908).

[25]245 U.S. at 257. *See* note 21 *supra*.

[26]*See generally* Appalachian Coals, Inc. v. United States, 288 U.S. 344, 359 (1933); United States v. Colgate & Co., 250 U.S. 300, 307 (1919); D.R. Wilder Mfg. Co. v. Corn Prods. Ref. Co., 236 U.S. 165, 173-74 (1915).

[27]Prior to its amendment by Act of Aug. 17, 1937, Pub. L. No. 314, § 690, 50 Stat. 693, the Sherman Act, § 1, provided, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal." Sherman Act, ch. 647, 26 Stat. 209 (current version at 15 U.S.C. § 1).

[28]In United States v. Workingmen's Amalgamated Council, 54 F. 994 (C.C.E.D. La., 1893), the court, interpreting the Sherman Act as outlawing such combinations whether the source be massed capital or labor, found that concerted activity was illegal as a combination in restraint of trade.

[29]158 U.S. 564 (1895).

[30]The American Railway Union, founded in 1893 by Eugene V. Debs, struck the Pullman Place Car Company, causing a nationwide transportation problem. A violent strike ensued which eventually resulted in the intervention of the United States Army. Debs and his associates were jailed for violating the court's injunction. The

Although the court of appeals had found[31] that section 1 of the Sherman Act[32] applied to labor organizations, the Supreme Court affirmed on narrower grounds.[33]

Following *In re Debs*,[34] there was a proliferation of injunctions against unions, resulting in an era of "law by injunction."[35] Public concern regarding the applicability of the Sherman Act to labor peaked after the famous *Danbury Hatters* case,[36] in which an unanimous Supreme Court held that labor unions were subject to the Sherman Act.[37]

### *B. Clayton Act*

Congress, by enacting the Clayton Anti-Trust Act,[38] moved to curb what it perceived as judicial excesses in the application of the

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resulting destruction of the union was, according to Debs, the result of the injunction not the military intervention.

Following the Pullman strike, a United States Strike Commission, recognizing the inequality of bargaining strength, prompted Congress to pass the Erdman Act in 1898 aiding organized labor. Erdman Act of June 1, 1898, ch. 370, 30 Stat. 424. However, in Adair v. United States, 208 U.S. 161 (1908), the Court struck it down because it unconstitutionally deprived employers of property without "due process of law." Additionally, the Court found that the employment relationship was local in nature and thus, not within the power of Congress to regulate under the Commerce Clause. *Id.* at 180.

[31]United States v. Debs, 64 F. 724 (C.C.N.D. Ill. 1894).

[32]*Id. See* note 27 *supra.*

[33]In re Debs, 158 U.S. at 600. Whether Congress intended for labor organizations to be subject to the Sherman Act was unclear. *See* E. BERMAN, LABOR AND THE SHERMAN ACT ch. 3 (1930) (maintaining that Congress did not intend for labor organizations to be subject to the Act). *But see* A. MASON, ORGANIZED LABOR AND THE LAW chs. 7-9 (1925) (maintaining that Congress did intend for labor organizations to be subject to the Act). However, the courts proceeded on the assumption that Congress did intend for labor organizations to be subject to the Act. *See* Gompers v. Bucks Stove & Range Co., 221 U.S. 418 (1911), in which the Court applied the Sherman Act to unlawful combinations of capital or labor.

[34]158 U.S. 564 (1895). *See also* Lewis, *A Protest Against Administering Criminal Law By Injunction—The Debs Case (1894)*, 33 AM. L. REG. (N.S.) 879 (1894).

[35]*See* S. REP. NO. 163, pt. 1, 72d Cong., 1st Sess. 18 (1932), *reprinted in* STATUTORY HISTORY OF THE UNITED STATES: LABOR ORGANIZATION 184-85 (R. Koretz ed. 1970).

[36]Lowew v. Lawlor, 208 U.S. 274 (1908).

[37]The Court stated:

> The act made no distinction between classes. It provided that "every" contract, combination or conspiracy in restraint of trade was illegal. The records of Congress show that several efforts were made to exempt, by legislation, organizations of farmers and laborers from the operation of the act and that all these efforts failed, so that the act reminded as we have it before us.

*Id.* at 301.

[38]Clayton Act, 38 Stat. 730 (current version at 15 U.S.C. § 12 (1976)).

Sherman Act.[39] Labor organizations, relying on sections 6[40] and 20,[41] perceived the Clayton Act as its "Magna Carta."[42] However, the only significant benefit that unions ultimately received under the Clayton Act was that they could not be dissolved by the courts as unlawful per se.[43]

Despite the obvious attempt by Congress to assist labor organizations by enactment of the Clayton Act, the Supreme Court emasculated the Act in *Duplex Printing Press Co. v. Deering*.[44] The Court held that

> there is nothing in the section [6] to exempt such an organization or its members from accountability where it or they depart from its normal and legitimate objects and engage in an actual combination or conspiracy in restraint of trade. And by no fair or permissible construction can it be taken as authorizing any activity otherwise unlawful, or enabling a normally lawful organization to become a cloak for an illegal combination or conspiracy in restraint of trade as defined by the anti-trust laws.[45]

The Court extrapolated this rationale from what it considered to be ambiguous language in sections 6 and 20 of the Clayton Act.[46] The

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[39]*See* Kovner, *The Legislative History of Section 6 of the Clayton Act*, 47 COLUM. L. REV. 749 (1947).

[40]Section 6 of the Clayton Act provides in part:

> [T]he labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

15 U.S.C. § 17 (1976).

[41]Section 20 of the Clayton Act prohibits federal judges from issuing injunctions in cases between employers and employees involving disputes arising out of terms and conditions of employment, except in very limited circumstances. 29 U.S.C. § 52 (1976).

[42]Curiously, in Hitchman Coal & Coke Co. v. Mitchell, 245 U.S. 229 (1917), the Supreme Court simply ignored section 6 in its decision.

[43]Overall, the Act may have been more detrimental than it was beneficial to the labor movement. Prior to the Clayton Act, under section 4 of the Sherman Act, only the government could move for an injunction. *See* Paine Lumber Co. v. Neal, 244 U.S. 459 (1917). However, section 16 of the Clayton Act, 15 U.S.C. § 26 (1976), expanded this right to private individuals with obviously detrimental ancillary effects on labor.

[44]254 U.S. 443 (1921).

[45]*Id.* at 469.

[46]The ambiguous language of section 6 includes "legitimate objects" and "lawfully" carried out. The ambiguous language of section 20 includes "peaceful means," "lawfully," and "peacefully."

courts relentlessly continued their application of anti-trust laws to labor organizations,[47] to the point where the double standard that they applied toward employers and labor became blatant. In *Bedford Cut Stone Co. v. Journeyman Stone Cutters Association*,[48] the Court applied an "effects" test[49] under which the pursuit of legitimate objectives was not determinative, but the result would be. The Court stated: "A restraint of interstate commerce cannot be justified by the fact that the ultimate object of the participants was to secure an ulterior benefit which they might have been at liberty to pursue by means not involving such restraint."[50] The distrustful attitude of labor toward the judiciary that developed during this period remained for some time.

## IV. Labor Legislation

### A. *Railway Labor Act*

Because of the continuing interference of the courts into labor matters,[51] the first purely labor relations piece of federal legislation, the Railway Labor Act,[52] was enacted. Although the Railway Labor Act was not as comprehensive[53] as the later National Labor Relations Act,[54] it clearly recognized the right of laborers to organize and bargain collectively,[55] and interestingly, imposed a mandatory injunction against employers to bargain with a certified union.[56] This mandatory injunction was upheld in *Virginian Railway v. System*

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[47]*See, e.g.*, United States v. Brims, 272 U.S. 549 (1926); United Leather Workers Local 66 v. Herkert & Meisel Trunk Co., 265 U.S. 457 (1924).

[48]274 U.S. 37 (1927).

[49]The same "effects" test had been rejected as applied to employers in United States v. E.C. Knight Co., 156 U.S. 1, 17 (1895).

[50]274 U.S. at 47.

[51]*See, e.g.*, Corondo Coal Co. v. UMW, 268 U.S. 295 (1925).

[52]Railway Labor Act, Pub. L. No. 257, ch. 347, 44 Stat. 577 (1926) (current version at 45 U.S.C. § 151 (1976)) (as amended by Railway Labor Act Amendments of 1934, ch. 691, § 3, 48 Stat. 1189 (current version at 45 U.S.C. § 153 (1976))).

[53]The Railway Labor Act had no enforcement agency similar to the National Labor Relations Board, no lists of prohibited practices similar to unfair labor practices, and no limitation on the amount of economic force that could be used in labor disputes. The Act did set up a National Railroad Adjustment Board for the resolution of disputes. Railway Labor Act, ch. 347, 44 Stat. 577, 578 (current version at 45 U.S.C. § 151 (1976)).

[54]National Labor Relations (Wagner) Act of July 5, 1935, Pub. L. No. 74-198, ch. 372, 49 Stat. 449 (1935) (current version at 29 U.S.C. §§ 151-69 (1976)) [hereinafter cited as the Wagner Act].

[55]*See* Texas & N.O. Ry. v. Brotherhood of Ry. & S.S. Clerks, 281 U.S. 548 (1930) (upholding the constitutionality of the Railway Labor Act).

[56]Railway Labor Act, ch. 347, 44 Stat. 577 (1926) (current version at 45 U.S.C. § 151 (1976)).

*Federation No. 40*,[57] despite the enactment in the interim of the Norris-LaGuardia Anti-Injunction Act.[58] Indeed, the Railway Labor Act had a significant impact on the law of labor injunctions in cases where an *accomodation* of the two Acts had to be struck.[59]

### *B. Norris-LaGuardia Act*

The Norris-LaGuardia Act was the preeminent legislative enactment dealing with labor injunctions. Prior to this Act, there was no general legislative labor law guidance, leaving the courts to rely upon common law and anti-trust law. The personal predilections of judges prevailed. Employers had turned to the injunction as their primary weapon because damage remedies often proved to be inadequate.[60] Injunctions were swift, effective, and often determinative but were subject to procedural inadequacies and substantive errors.[61] Against this backdrop, Congress, through the Norris-LaGuardia Act, sought to limit the federal courts by withdrawing their injunctive power.[62]

In the Norris-LaGuardia Act, Congress set forth a broad prohibition:

> [N]o court of the United States, as herein defined, shall have jurisdiction to issue any restraining order or temporary or

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[57]300 U.S. 515, 562-63 (1937). The Court viewed the Railway Labor Act, as amended in 1934, as a more recent and more specific legislative act than the Norris-LaGuardia Act. Therefore, this injunctive provision was crucial and created only a minimal intrusion into the Norris-LaGuardia Act. *Id.*

[58]Norris-LaGuardia Act, Pub. L. No. 65, ch. 90, 47 Stat. 70 (1932) (current version at 29 U.S.C. §§ 101-15 (1976)).

[59]The Norris-LaGuardia Act did not deprive federal courts of jurisdiction to compel compliance with positive mandates of the Railway Labor Act. Graham v. Brotherhood of Locomotive Firemen, 338 U.S. 232, 237 (1949). Also, in Steele v. Louisville & N.R.R., 323 U.S. 192 (1944), the Court enjoined the union to give fair representation to all employees. *See also* Tunstall v. Brotherhood of Locomotive Firemen, 323 U.S. 210 (1944). *See generally* Comment, *Labor Injunctions and Judge-Made Labor Law: The Contemporary Role of Norris-LaGuardia*, 70 YALE L.J. 70 (1960).

[60]Among the inadequacies were the procedural difficulties in suing a union *qua* union, the judgment-proof status of many unions and the interminable delays.

[61]Decisions were often ex parte and based on misleading evidence. Hasty decisions made in an emotionally charged atmosphere based upon amorphous and illusory substantive law resulted in many errors. Although these errors could be corrected in later proceedings, in practice the initiative and morale of the union had been broken. Employers had the unions' economic power in check while their own was relatively unabated.

[62]In Marine Cooks & Stewards, A.F.L. v. Panama S.S. Co., 362 U.S. 365, 369 n.7 (1960), the Court noted that the Norris-LaGuardia Act "was prompted by a desire . . . to withdraw federal courts from a type of controversy for which many believed they were ill-suited and from participation in which, it was feared, judicial prestige might suffer."

> permanent injunction in a case involving or growing out of a labor dispute, except in a strict conformity with the provisions of this Act; nor shall any such restraining order or temporary or permanent injunction be issued contrary to the public policy declared in this Act.[63]

Section 4 of the Act provided a similar proscription and delineated specific acts, including strikes and picketing, which would not be enjoined.[64] Thus, the Act put an end to the criminal conspiracies and the civil "objectives" test theories[65] and brought judicial interpretation of the use of injunctions in anti-trust cases into proper perspective.[66] The Norris-LaGuardia Act reflected the laissez-faire philosophy of Congress,[67] a philosophy which had to be accommodated to prior and subsequent regulatory schemes.[68]

Accommodation with the Railway Labor Act was usually effected with minimal intrusion into the Norris-LaGuardia Act.[69] However, when the Supreme Court enjoined a strike in *Brotherhood of Railroad Trainmen v. Chicago River & Indiana Railway*,[70] its holding was in direct conflict with the specific language of section 4 of the Norris-LaGuardia Act.[71] The Court stated:

> We hold that the Norris-LaGuardia Act cannot be read alone in matters dealing with railway labor disputes. There must be an accomodation of that statute and the Railway Labor Act so that the obvious purpose in the enactment of

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[63]Norris-LaGuardia Act, ch. 90, 47 Stat. 70 (current version at 29 U.S.C. § 101 (1976)).

[64]*Id.* at 70-71 (current version at 29 U.S.C. § 104 (1976)).

[65]As there was no mention of "objectives" in the Norris-LaGuardia Act, the court in Wilson & Co. v. Birl, 27 F. Supp. 915, 917 (E.D. Pa.), *aff'd*, 105 F.2d 948 (3d Cir. 1939), concluded that the rationale of the dissent in Duplex Printing Press Co. v. Deering, 254 U.S. 443, 479 (1921) (Brandeis, J., dissenting), was the intended result.

[66]*See, e.g.*, Apex Hosiery Co. v. Leader, 310 U.S. 469 (1940), wherein the Court indicated that a union, pursuing its own interest by lawful means, did not violate anti-trust laws, thus reversing the restrictive precedents. *See also* United States v. Hutcheson, 312 U.S. 219 (1941) in which the Court resurrected section 20 of the Clayton Act.

[67]*See* S. REP. NO. 163, pt. 1, 72d Cong., 1st Sess. 18 (1932), *reprinted in* STATUTORY HISTORY OF THE UNITED STATES: LABOR ORGANIZATION 184-85 (R. Koretz ed. 1970); H.R. REP. NO. 669, 72d Cong., 1st Sess. 3 (1932), *reprinted in* STATUTORY HISTORY OF THE UNITED STATES: LABOR ORGANIZATION 193-94 (R. Koretz ed. 1970).

[68]*See generally* Loeb, *Accommodation of the Norris-LaGuardia Act to Other Federal Statutes*, 11 LAB. L.J. 473 (1960).

[69]*See, e.g.*, Steele v. Louisville & N.R.R., 323 U.S. 192 (1944); Virginian Ry. v. System Fed'n No. 40, 300 U.S. 515 (1937).

[70]353 U.S. 30 (1957).

[71]*Id.* at 42. Compare this holding with the Norris-LaGuardia Act, ch. 90, 47 Stat. (current version at 29 U.S.C. § 104 (1976)).

> each is preserved. We think that the purposes of these Acts are reconcilable.[72]

Thus, the Court, in holding the injunction permissible,[73] looked at both statutes as "part of a pattern of labor legislation."[74]

### *C. The Wagner Act*

The task of accommodating the Railway Labor Act[75] and the Norris-LaGuardia Act was immeasurably different from that of accommodating the latter act with the Wagner Act,[76] because the Wagner Act was passed subsequent to the Norris-LaGuardia Act with a full congressional debate on its impact. The Wagner Act, to a limited extent, reopened the door to federal court use of the labor injunction. Section 10(e)[77] granted power to the National Labor Relations Board to seek judicial enforcement of its orders in the appropriate United States circuit court of appeals. In granting jurisdiction to the circuit courts to entertain such proceedings, the Wagner Act specifically bestowed the power to grant equitable relief, including "such temporary relief or restraining order as it deems just and proper."[78] Section 10(f)[79] allowed petitions to be filed by "[a]ny person aggrieved by a final order of the Board," with the grant of jurisdiction and equitable relief power identical to that of section 10(e). The courts were not presented with any ambiguity as to the congressional intent vis-a-vis Norris-LaGuardia, because section 10(h) specifically rendered Norris-LaGuardia inapplicable.[80]

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[72]353 U.S. at 40.

[73]The court believed that the Adjustment Board provided a reasonable alternative to the limited concession of the right to strike. To offset this inbalance of economic power, the Court, in Brotherhood of Locomotive Eng'rs v. Missouri-Kansas-Texas R.R. Co., 363 U.S. 528 (1960) held that as a condition precedent to the issuance of such an injunction, management could be ordered to maintain the status quo. *Id.* at 535.

[74]353 U.S. at 42.

[75]Railway Labor Act, ch. 347, 44 Stat. 577 (current version at 45 U.S.C. §§ 151-188 (1976)).

[76]The Wagner Act, ch. 372, 49 Stat. 449 (current version at 29 U.S.C. § 160 (1976)).

[77]Wagner Act, § 10(e), 49 Stat. at 454-55 (current version at 29 U.S.C. § 160(e) (1976)).

[78]Wagner Act, § 10(e) 49 Stat. at 454 (current version at 29 U.S.C. § 160(e) (1976)).

[79]Wagner Act, § 10(f) 49 Stat. 454 (current version at 29 U.S.C. § 160(f) (1976)).

[80]Wagner Act, § 10(h) 49 Stat. 454 (current version at 29 U.S.C. § 160(h) (1976)). Section 10(h) of the National Labor Relations Act provides:

> When granting appropriate temporary relief or a restraining order, or making and entering a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part an order of the board, as provided in this section, the jurisdiction of courts sitting in equity shall not be limited by [the Norris-LaGuardia Act].

However, in *Fur Workers Union Local 72 v. Fur Workers Union No. 21238*,[81] the court held that the Wagner Act did not modify the Norris-LaGuardia Act prerequisites to the issuance of labor injunctions.[82] Nevertheless, section 10(h) was not a signal to return to the pre-Norris-LaGuardia days, because it was later determined that section 10(h) did not carry with it any private rights to seek injunctions.[83]

### *D. Taft-Hartley Act*

In 1947, the Wagner Act was amended by the Labor Management Relations (Taft-Hartley) Act.[84] With enactment of the Wagner Act, Congress focused on actions of employers; with enactment of the Taft-Hartley Act, Congress evidenced a change of attitude toward the role of unions by adding a list of union unfair labor practices to balance the Wagner Act list against employers.[85] This change was prompted by certain post-Wagner Act practices of organized labor which Congress perceived as causing industrial unrest and coercive influence by unions over employees. Although Congress, in the Taft-Hartley Act expressly accepted the desirability of collective bargaining, it determined that change in the remedial and enforcement provisions of the Wagner Act was required.

This change necessarily required an examination of the efficacy of the injunction as a remedial device. In section 101 of the Taft-Hartley Act, Congress added among others sections 10(*l*) and 10 (j) to the Wagner Act. Section 10(*l*) compels the Board to seek an injunction whenever a union is charged with violating section 8(b)(4), subsections (A), (B), or (C), and the regional director has reasonable cause

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[81]105 F.2d 1, 17 (D.C. Cir.), *aff'd mem.*, 308 U.S. 522 (1939).

[82]Earlier courts interpreting the impact of the Wagner Act seemed to be more concerned with the question of whether a particular dispute was a "labor dispute" and thus within the ambit of the Wagner Act. *See, e.g.*, International Union of United Brewery v. California State Brewers Inst., 25 F. Supp. 870 (S.D. Cal. 1938), *rev'd on other grounds*, 106 F.2d 871 (9th Cir. 1939) (involved jurisdictional dispute not between employer and employees, thus no true labor dispute); Grace Co. v. Williams, 20 F. Supp. 263 (W.D. Mo. 1937) (certification of bargaining representative was no "labor dispute"). *But cf.*, Donnelly Garment Co. v. I.L.G.W., 99 F.2d 309 (8th Cir. 1938) and Cupples Co. v. A.F.L., 20 F. Supp. 894 (E.D. Mo. 1937) (finding labor disputes existed).

[83]Bakery Sales Drives, Local No. 33 v. Wagshal, 333 U.S. 437, 442 (1948).

[84]Labor Management Relations (Taft-Hartley) Act, Pub. L. No. 101, ch. 120, 61 Stat. 136 (1947) (as amended by Labor-Management Reporting and Disclosure Act, Pub. L. No. 86-257, 73 Stat. 519 (1959) (current version at 29 U.S.C. § 401 (1976))) (current version at 29 U.S.C. § 141 (1976)).

[85]Taft-Hartley Act, § 8(b), 61 Stat. 141 (current version at 29 U.S.C. § 158(b) (1976)).

to believe the charge is true.[86] Although section 10(*l*) does not have language specifically exempting it from the Norris-LaGuardia Act, it does state that injunctive relief can be granted "notwithstanding any other provision of law."[87] Section 10(j) grants the Board discretionary power to seek an injunction in any case where it has issued an unfair labor practice complaint against an employer or a union.[88] This section contains no exempting language similar to sections 10(h) or 10(*l*). Nevertheless, the court in *Douds v. Local 294, International Brotherhood of Teamsters*,[89] stated:

> The measure of the court's jurisdiction is similar in both subdivisions (j) and (*l*); to-wit, to grant such injunctive relief or temporary restraining order as it deems just and proper. No other grant or limitation of power is found.
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> . . . .
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> . . . When the court is given jurisdiction without limitation, the Act means just that; the phrase [notwithstanding any other provision of law] may be considered as surplusage. Certainly, it can not be used to imply a limitation upon another subsection where the phrase is not found.[90]

The resurrection of the injunction in federal courts as a mode of regulating labor disputes under sections 10(j) and 10(*l*) can be reconciled with the underlying rationale of the Norris-LaGuardia Act, because procedural safeguards[91] obviate many of the evils previously associated with the private use of labor injunctions.[92]

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[86]Taft-Hartley Act, § 10(*l*), 61 Stat. 149 (current version at 29 U.S.C. § 160(*l*) (1976)).

[87]Taft-Hartley Act, § 10(*l*), 61 Stat. 149 (current version at 29 U.S.C. § 160(*l*) (1976)). Section (h) carries such an express exception. Taft-Hartley Act, § 10(h), 61 Stat. 149 (current version at 29 U.S.C. § 160(h) (1976)). *See also* § 208(a) of the Taft-Hartley Act, which states that the provisions of the Norris-LaGuardia Act are inapplicable in situations dealing with national health or safety. Taft-Hartley Act, ch. 120, § 208(a), 61 Stat. 155 (current version at 29 U.S.C. § 178 (1976)).

[88]Taft-Hartley Act, § 10(j), 61 Stat. 149 (current version at 29 U.S.C. § 160(j) (1976)).

[89]75 F. Supp. 414 (N.D.N.Y. 1947).

[90]*Id.* at 417-18.

[91]The Board must make preliminary findings of fact and law justifying the issuance of the unfair labor practice complaint. The petition for the injunction must allege substantial and irreparable injury or else the person charged must be given notice and the right to appear and present testimony prior to the issuance of the injunction. Taft-Hartley Act, ch. 120, § 10(*l*)), 61 Stat. 149 (current version at 29 U.S.C. § 160(*l*) (1976)).

[92]Injunctive relief upon petition of private parties was not contemplated under these sections of the Act. G. VAN ARKEL, AN ANALYSIS OF THE LABOR MANAGEMENT RELATIONS ACT OF 1947, 63 (1947). In Amazon Cotton Mill Co. v. Textile Workers Union, 167 F.2d 183, 190 (4th Cir. 1948), the court upheld the exclusive jurisdiction of

Section 301(a) of the Taft-Hartley Act caused the greatest difficulty in accommodating the Norris-LaGuardia Act and eventually thrust federal courts back into a preeminent role in establishing labor policy. Section 301(a) states:

> Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this Act, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.[93]

Ostensibly, this provision granted federal courts plenary jurisdiction in suits between employers and unions over contract violation disputes. Such a broad jurisdictional grant would be expected to carry with it the full panoply of legal and equitable remedial power, including the injunction. The legislative history, however, casts doubt on such an assumption. A comparison of the original versions of section 301(a) indicates that Congress did not intend a *sub silentio* authorization of federal injunctive relief. The Senate version[94] made collective bargaining agreement breaches unfair labor practices and gave the Board injunctive power under section 10(j) to enjoin such violations. The House version,[95] however, provided that violations of the collective bargaining agreement fell within the jurisdiction of the federal courts and expressly authorized the issuance of injunctions against private parties for such violations. This latter grant would have been a de facto repeal of Norris-LaGuardia Act in this area. The conference committee accepted the House version but eliminated the portion which reinstituted private injunctive relief.[96] Thus, the apparent Congressional rejection of injunctive relief in section 301(a) as evidenced by its history, coupled with a broad jurisdictional grant, presumably including full remedial powers, renders the section instrinsically inconsistent. Although it is obvious that the Taft-Hartley Act made some inroads into Norris-

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the Board to petition for 10(*l*) injunctions. *See also*, International Longshoremen's and Warehousemen's Local No. 6 v. Sunset Line & Twine Co., 77 F. Supp. 119 (N.D. Cal. 1948).

[93]Taft-Hartley Act, ch. 120, § 301(a), 61 Stat. 156 (current version at 29 U.S.C. § 185(a) (1976)).

[94]S. 1126, 80th Cong., 1st Sess., § 8(b)(5) (1947), *reprinted in* 1 NLRB, LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT, 1947, at 114 (1948).

[95]H.R. 3020, 80th Cong., 1st Sess., § 302(e) (1947), *reprinted in* 1 NLRB, LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT, 1947, at 95 (1948).

[96]H.R. CONF. REP. NO. 510, 80th Cong., 1st Sess. 67, *reprinted in* [1947] U.S. CODE CONG. & AD. NEWS 1135, 1174.

LaGuardia's restrictions, the absence of definitive criteria in section 301(a) renders nebulous the exact extent.

## V. JUDICIAL INTERPRETATION

### *A.* Lincoln Mills *to* Avco

Section 301(a) is framed in such broad jurisdictional terms that a split arose among the circuits as to whether the section was only a procedural grant[97] or an authorization for federal substantive law.[98] In *Textile Workers Union v. Lincoln Mills of Alabama*,[99] the Supreme Court resolved this split in the context of a suit to compel arbitration.[100] The Court focused on the Congressional intent of section 301(a) to make collective bargaining agreements "equally binding and enforceable."[101] The Court concluded that "[T]he substantive law to apply in suits under § 301(a) is federal law, which the courts must fashion from the policy of our national labor laws. . . . The range of judicial inventiveness will be determined by the nature of the problem."[102] Recognizing that an employer's agreement to arbitrate is the quid pro quo for a no-strike clause, the Court adopted the rationale expressed in *Textile Workers Union v. American Thread Co.*[103] in stating that section 301 "authorizes federal courts to fashion a body of federal law for the enforcement of these collective bargaining agreements and includes within that federal law specific performance of promises to arbitrate grievances under collective bargaining agreements."[104] The Court did not feel constricted by the stiff procedural requirements of section 7 of the Norris-LaGuardia Act, and asserted that a failure to comply with an agreement to arbitrate was not similar to the type of acts listed in section 4 which had given rise to abuses of the injunctive power against which the

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[97]*See, e.g.*, I.L.G.W. v. Jay-Ann Co., 228 F.2d 632 (5th Cir. 1956); Mercury Oil Ref. Co. v. Oil Workers Int'l Union, 187 F.2d 980 (10th Cir. 1951).

[98]*See, e.g.*, Signal-Stat Corp. v. Local 475, United Elec. Radio and Mach. Workers, 235 F.2d 298 (2d Cir. 1956), *cert. denied*, 354 U.S. 911 (1957); United Elec. Radio and Mach. Workers v. Oliver Corp., 205 F.2d 376 (8th Cir. 1953).

[99]353 U.S. 448 (1957).

[100]The employer, after complying with graduated steps of a negotiated grievance procedure pursuant to a contract that contained a no-strike clause and a broad arbitration clause, refused to submit to arbitration. The district court's order to arbitrate was reversed by the circuit court which held that § 301(a) granted jurisdiction but not the power to grant the requested relief. Lincoln Mills v. Textile Workers Union, 230 F.2d 81 (5th Cir. 1956).

[101]353 U.S. at 454 (quoting S. REP. NO. 105, 80th Cong., 1st Sess. 15 (1947)).

[102]353 U.S. at 456-57. The Court noted Mendelsohn, *Enforceability of Arbitration Agreements Under Taft-Hartley Section 301*, 66 YALE L.J. 167 (1956).

[103]113 F. Supp. 137 (D. Mass. 1953).

[104]353 U.S. at 451.

Norris-LaGuardia Act was aimed.[105] Admitting that a literal reading of the Norris-LaGuardia Act would bring the dispute within its purview, the Court, relying on section 8 which evinces a Congressional policy in favor of "voluntary arbitration," nevertheless reasoned that "the congressional policy in favor of the enforcement of agreements to arbitrate grievance disputes being clear, there is no reason to submit them to the requirements of § 7 of the Norris-LaGuardia Act."[106] However, although arbitration could be compelled, the status of injunctions to prevent violations of no-strike clauses was uncertain.

The preference for the peaceful resolution of labor disputes via arbitration, having received Congressional approval, continued to receive judicial blessing. In the *Steelworkers Trilogy*,[107] the Court stated:

> "Final adjustment by a method agreed upon by the parties is hereby declared to be the desirable method for settlement of grievance disputes arising over the application or interpretation of an existing collective bargaining agreement. . . ." That policy can be effectuated only if the means chosen by the parties for settlement of their differences under a collective bargaining agreement is given full play.[108]

The Court cautioned, however, that the function of the federal courts is not to weigh the merits of the grievance but to ascertain "whether the party seeking arbitration is making a claim which on its face is governed by the contract."[109] Noting that "arbitration is the substitute for industrial strife,"[110] the Court stated that the arbitrator is knowledgable in the "common law of the shop."[111] Therefore, absent an express exclusionary provision or other forceful evidence, "[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage."[112]

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[105]*Id.* at 458.

[106]*Id.*

[107]*See, e.g.*, United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960).

[108]United Steelworkers v. American Mfg. Co., 363 U.S. at 566 (quoting the Labor Management Relations Act, 1947, 29 U.S.C. § 173 (1976) (amended 29 U.S.C. § 173 (Supp. III 1979)).

[109]363 U.S. at 568.

[110]United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. at 578.

[111]*Id.* at 582. *Accord*, Cox, *Reflections Upon Labor Arbitration*, 72 HARV. L. REV. 1482, 1498-1500 (1959).

[112]363 U.S. at 582-83.

Two years later, in *Charles Dowd Box Co. v. Courtney*,[113] the Supreme Court recognized that state courts were not divested of their jurisdiction to entertain suits for contract violations between employers and unions.[114] In rejecting any federal "exclusivity" in this area, the Court relied upon the permissive "may" language of section 301(a), as opposed to mandatory "shall" language, and the fact that Congress left the enforcement of collective bargaining agreements "to the usual processes of the law."[115] However, the Court quickly dispelled any notion that state court concurrent jurisdiction would be allowed to create a multifarious body of substantive labor law. In *Local 174, Teamsters v. Lucas Flour Co.*,[116] the Supreme Court held that "incompatible doctrines of local law must give way to principles of federal labor law. . . . The dimensions of § 301 require the conclusion that substantive principles of federal labor law must be paramount in the area covered by the statute."[117] Thus, a state court proceeding would be procedurally appropriate, but the substantive law to be applied was federal.

In *Lincoln Mills*, the *Steelworkers Trilogy*, and *Lucas Flour*, the suits to compel arbitration were union initiated. Employers soon began to question whether they could likewise expect judicial enforcement of the union side of the bargain—the no-strike clause. Although a split developed among the circuits,[118] the issue was resolved in *Sinclair Refining Co. v. Atkinson*.[119] In *Sinclair* the employer, seeking to enjoin a union violation of a no-strike clause, relied upon the Congressional concern expressed in section 2 of the Norris-LaGuardia Act "to protect concerted activities for the purpose of collective bargaining."[120] The employer contended that

> [a]n interpretation of the term "labor dispute" so as to include a dispute arising out of a union's refusal to abide by the terms of a collective agreement to which it freely acceded is

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[113]368 U.S. 502 (1962).

[114]*Id.* The Court rejected the analogy to San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236 (1959), in which the Court recognized the necessity of withdrawing from the state courts, jurisdiction over controversies subject to the jurisdiction of the NLRB. 368 U.S. at 507.

[115]368 U.S. at 511.

[116]369 U.S. 95 (1962).

[117]*Id.* at 102-03. *Accord*, Humphrey v. Moore, 375 U.S. 335 (1964).

[118]*See* Chauffeurs Local 795 v. Yellow Transit Freight Lines, Inc., 282 F.2d 345 (10th Cir. 1960), *rev'd per curiam*, 370 U.S. 711 (1962) (upholding an injunction in violation of a no-strike clause). *But see* A.H. Bull S.S. Co. v. Seafarers' Int'l Union, 250 F.2d 326 (2d Cir. 1957), *cert. denied*, 355 U.S. 932 (1958) (refusing to uphold an injunction in a similar case).

[119]370 U.S. 195 (1962) (overruled in Boys Mkts., Inc. v. Retail Clerks, Local 770, 398 U.S. 235 (1970)).

[120]370 U.S. at 201.

> to apply the Norris-LaGuardia Act in a way that defeats one of the purposes for which it was enacted.[121]

Although the Court recognized this as a forceful argument with support among the legal commentaries,[122] it declared that nothing in section 2 narrowed the broad definition of "labor dispute,"[123] and that section 301(a) "was not intended to have any such partially repealing effect upon such a long-standing, carefully thought out and highly significant part of this country's labor legislation as the Norris-LaGuardia Act."[124] The Court distinguished its holding in *Sinclair* from that in *Lincoln Mills* because the latter involved injunctions against failure to arbitrate, which Norris-LaGuardia was not intended to prevent, while the former involved injunctions to prevent strikes, at which Norris-LaGuardia was specifically directed.[125] The Court refused to accomodate section 4 of the Norris-LaGuardia Act and section 301(a) of the Taft-Hartley Act.

In a noteworthy dissent, Justice Brennan stated:

> Of course § 301 of the Taft-Hartley Act did not, for purposes of actions brought under it, "repeal" § 4 of the Norris-LaGuardia Act. But the two provisions do coexist, and it is clear beyond dispute that they apply to the case before us in apparently conflicting senses. Our duty, therefore, is to seek out that accommodation of the two which will give the fullest possible effect to the central purposes of both.[126]

Justice Brennan noted that while section 301 does not specifically address the remedy question, a court's function may be crippled if it is deprived of its injunctive power.[127] Also, when faced with this surface conflict, prior decisions had flexibly applied the Norris-LaGuardia language.[128] Therefore, Justice Brennan justifiably considered the majority opinion in *Sinclair* to be out of harmony with prior decisions.[129]

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[121]*Id.*

[122]*See* Gregory, *The Law of the Collective Agreement*, 57 MICH. L. REV. 635 (1959); Rice, *A Paradox of Our National Labor Law*, 34 MARQ. L. REV. 233 (1951); Stewart, *No-Strike Clauses in the Federal Courts*, 59 MICH. L. REV. 673 (1961).

[123]370 U.S. at 202 n.13 (quoting Lauf v. E.G. Shinner & Co., 303 U.S. 323, 330 (1938)).

[124]370 U.S. at 203.

[125]*Id.* at 212. *See* Keene, *The Supreme Court, Section 301 and No- Strike Clauses: From* Lincoln Mills *to* Avco *and Beyond*, 15 VILL. L. REV. 32, 49 (1969).

[126]370 U.S. at 215-16 (Brennan, J., dissenting).

[127]*Id.* at 216-17.

[128]*Id.* at 217. In *Lincoln Mills*, § 7 of the Norris-LaGuardia Act was *accommodated* to § 301(a) of the Taft-Hartley Act. *Id.* at 219.

[129]Brennan stated, "Accommodation requires only that the anti-injunction policy of Norris-LaGuardia not intrude into areas not vital to its ends, where injunctive relief is

Additionally, Justice Brennan realized the effect of the decision on state court injunctive relief. The state courts would become the preferred forum for enforcement of arbitration agreements placing the "development of a uniform body of federal contract law . . . in for hard times."[130] Finally, if removal to federal courts were allowed, it would result in an extension of the Norris-LaGuardia Act to the states, effectively negating their injunctive power.[131]

Although *Sinclair* ostensibly left state court injunctive power intact, the tactical procedural maneuver of the federal removal statute[132] quickly preempted the field. Courts had to grapple with the question of whether the Norris-LaGuardia Act denied jurisdiction to the federal courts when the sole relief requested in a labor dispute was an injunction. Again a split arose among the circuits.[133] The question was answered in *Avco Corp. v. Aero Lodge No. 735*[134] in which the Supreme Court held:

> Removal is but one aspect of "the primacy of the federal judiciary in deciding questions of federal law." *See England v. Medical Examiners*, 375 U.S. 411, 415-416.
>
> It is thus clear that the claim under this collective bargaining agreement is one arising under the "laws of the United States" within the meaning of the removal statute. 28 U.S.C. § 1441(b). It likewise seems clear that this suit is within the "original jurisdiction" of the District Court within the meaning of 28 U.S.C. §§ 1441(a) and (b).[135]

Thus, the holding in *Sinclair* was unquestionably extended to the state courts.[136] The three concurring justices in *Avco*, realizing the impact of the decision in connection with *Sinclair*, expressed a willingness to reconsider *Sinclair* at an appropriate time.[137]

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vital to a purpose of § 301; it does not require unconditional surrender." 370 U.S. at 225 (Brennan, J., dissenting).

[130]*Id.* at 226.

[131]*Id.* at 227.

[132]28 U.S.C. § 1441(a) (1976).

[133]In American Dredging Co. v. Local 25, Marine Div., Int'l Union of Operating Eng'rs, 338 F.2d 837 (3d Cir. 1964), *cert. denied*, 380 U.S. 935 (1965), the court found no jurisdiction under 28 U.S.C. § 1441(a) (1976). *Contra*, Avco Corp. v. Aero Lodge No. 735, 376 F.2d 337 (6th Cir. 1967), *aff'd*, 390 U.S. 557 (1968), wherein the court found jurisdiction.

[134]390 U.S. at 557, *rehearing denied*, 391 U.S. 929 (1968).

[135]390 U.S. at 560 (footnote omitted).

[136]Indeed, some commentators thought that *Sinclair* should be so extended. *See, e.g.*, Dunau, *Three Problems in Labor Arbitration*, 55 VA. L. REV. 427, 468-73 (1969).

[137]390 U.S. at 562 (Stewart, Harlan, and Brennan, J.J., concurring).

### *B.* Boys Markets *and Beyond*

The opportunity to reconsider *Sinclair* presented itself in *Boys Markets, Inc. v. Retail Clerks Union, Local 770,*[138] in which a state court issued an injunctive order against a violation of a no-strike clause. The case was removed to the district court, which upheld the order. The Ninth Circuit, relying on *Sinclair*, reversed the holding.[139] However, the Supreme Court found that the holding of *Sinclair* represented a "significant departure from [a] . . . consistent . . . congressional policy [favoring] . . . arbitration" and was undermined by subsequent events, requiring its overruling.[140] The Court declared, "The principal practical effect of *Avco* and *Sinclair* taken together is nothing less than to oust state courts of jurisdiction in § 301(a) suits where injunctive relief is sought for breach of a no-strike obligation."[141] Such an occurrence would result in rampant forum shopping based on the availability of injunctive relief and frustrate efforts to establish a uniform federal labor law. It would effectively eliminate equitable remedies leaving only inadequate money damages.[142] The Court accommodated the instant situation under section 301(a) with the Norris-LaGuardia Act because the abuses which led to the latter were not present. However, the Court noted that its holding was a very narrow one and set forth strict criteria for the issuance of injunctions in this area. Adopting his own language from the *Sinclair* dissent, Justice Brennan speaking for the court stated:

> A District Court entertaining an action under § 301 may not grant injunctive relief against concerted activity unless and until it decides that the case is one in which an injunction would be appropriate despite the Norris-LaGuardia Act. When a strike is sought to be enjoined because it is over a grievance which both parties are contractually bound to arbitrate, the District Court may issue no injunctive order until it first holds that the contract *does* have that effect; and the employer should be ordered to arbitrate, as a condition

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[138]398 U.S. 235 (1970).

[139]416 F.2d 368 (9th Cir. 1969), *rev'd*, 398 U.S. 235 (1970).

[140]398 U.S. at 241. The Court refused to accept congressional silence *re Sinclair* as approval, noting that "[i]t is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law." *Id.* (quoting Girouard v. United States, 328 U.S. 61, 69 (1946)).

[141]398 U.S. at 244-45.

[142]Even Justice Black, in his dissenting opinion in *Boys Mkts.*, recognized that damages were not as effective as injunctions in stating, "[t]he court would have it that these techniques [money damages] are less effective than an injunction. That is doubtless true." 398 U.S. at 261 (Black, J., dissenting). *Accord*, Edwards & Bergmann, *The Legal and Practical Remedies Available to Employers to Enforce a Contractual "No-Strike" Commitment*, 21 LAB. L.J. 3 (1970).

> of his obtaining an injunction against the strike. Beyond this, the District Court must, of course, consider whether issuance of an injunction would be warranted under ordinary principles of equity—whether breaches are occurring and will continue, or have been threatened and will be committed; whether they have caused or will cause irreparable injury to the employer; and whether the employer will suffer more from the denial of an injunction than will the union from its issuance.[143]

Thus, the Court felt that the "overriding interest in the successful implementation of the arbitration process"[144] required this limited intrusion into the broad nonintervention policy of the Norris-LaGuardia Act.

The Supreme Court had an opportunity to address the *Boys Markets* criteria in a slightly expanded manner in *Gateway Coal Co. v. UMW.*[145] Applying the presumption in favor of arbitration established in the *Steelworkers Trilogy* and under section 203(d) of the Taft-Hartley Act to safety disputes,[146] the Court addressed the applicability of *Boys Markets* to situations in which, despite a broad arbitration clause, there was no express no-strike clause. The Court held, "Although the collective-bargaining agreement in *Boys Markets* contained an express no-strike clause, injunctive relief also may be granted on the basis of an implied undertaking not to strike."[147] Realizing that, although unusual, it was possible that the contractual intent of the parties was to have a broad arbitration clause without a no-strike clause, the Court stated, "Absent an explicit expression of such an intention, however, the agreement to arbitrate and the duty not to strike should be construed as having coterminous application."[148] The Court, having found an implied no-strike agreement and that the limited exception to express or implied no-strike clauses under section 502 was inapplicable,[149] upheld the district court injunction.

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[143]398 U.S. at 254 (quoting Sinclair Ref. Co. v. Atkinson, 370 U.S. 195, 228 (1962) (Brennan, J., dissenting)).

[144]398 U.S. at 252.

[145]414 U.S. 368 (1974).

[146]The Court stated, "Relegating safety disputes to the arena of economic combat offers no greater assurance that the ultimate resolution will ensure employee safety. Indeed, the safety of the workshop would then depend on the relative economic strength of the parties rather than on an informed and impartial assessment of the facts." *Id.* at 379.

[147]*Id.* at 381 (footnote omitted).

[148]*Id.* at 382.

[149]The Taft-Hartley Act § 502, 29 U.S.C. § 143 (1976), provides, in part, "[N]or shall the quitting of labor by an employee or employees in good faith because of abnormally dangerous conditions for work at the place of employment of such employee or

Another aspect of the *Boys Markets* criteria to receive additional amplification was the "over an arbitrable dispute" requirement. The issue arose in the context of sympathy strikes when, after a split in the circuits,[150] the Supreme Court decided *Buffalo Forge Co. v. Steelworkers.*[151] The Court held that a sympathy strike, "was not *over* any dispute between the Union and the employer that was even remotely subject to the arbitration provisions of the contract. . . . The strike had neither the purpose nor the effect of denying or evading an obligation to arbitrate or of depriving the employer of its bargain."[152] Although the question of whether the strike itself was a violation of the no-strike clause was conceded to be an arbitrable issue,[153] because the underlying cause of the strike—sympathy—was not an arbitrate issue, the Court would not enjoin it. To hold otherwise the Court acknowledged "would cut deeply into the policy of the Norris-LaGuardia Act."[154]

## VI. Prospective Injunctions: A View of the Circuits

### *A. Generally*

The question left unanswered after *Boys Markets* and its progeny is the availability of prospective injunctions. The typical injunction halts an on-going strike over a particular dispute. Absent the injunction, the strike would continue into the future; therefore, although directed at terminating an existing condition, the ultimate effect is somewhat prospective in nature. Conversely, a prospective injunction is directed not at an existing condition but at a dispute arising in the future over an arbitrable issue. Issuance of prospective injunctive relief is usually based on a history of similar strikes which portend a reasonable likelihood of future repetition. The benefit the

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employees be deemed a strike under this chapter." The Court found this section inapplicable because the union presented no "ascertainable, objective evidence supporting its conclusion that an abnormally dangerous condition for work exists." 414 U.S. at 387 (quoting Gateway Coal Co. v. UMW, 466 F.2d 1157, 1162 (1972)).

[150]*See* Plain Dealer Publishing Co. v. Cleveland Typographical Local 53, 520 F.2d 1220 (6th Cir. 1975), *cert. denied*, 928 U.S. 909 (1976); Amstar Corp. v. Amalgamated Meat Cutters, 468 F.2d 1372 (5th Cir. 1972) (holding no injunction against a sympathy strike). *But see* Valmac Indus., Inc. v. Food Handlers Local 425, 519 F.2d 263 (8th Cir. 1975), *vacated and remanded*, 428 U.S. 905 (1976); NAPA Pittsburg, Inc. v. Automotive Chauffers Local 926, 502 F.2d 321 (3d Cir.) (en banc), *cert. denied*, 419 U.S. 1049 (1974); Monongahela Power Co. v. Local 2332, IBEW, 484 F.2d 1029 (4th Cir. 1973) (holding that an injunction against a sympathy strike was permissible).

[151]428 U.S. 397 (1976).

[152]*Id.* at 407-08.

[153]The court stated that the employer could obtain a court order compelling the union to arbitrate this issue and later obtain an order enforcing the arbitrator's decision. *Id.* at 410.

[154]*Id.*

employer is that when the anticipated violation occurs, the union is immediately in violation of a standing court order and thus, subject to contempt citations.

The courts have moved cautiously in this area, mindful of congressional reaction to perceived judicial abuse of the injunctive power as evidenced by the Norris-LaGuardia Act. The issuance of a prospective injunction would require an extension of the admittedly narrow exception carved out in *Boys Markets*. Although the precise issue has not been decided by the Supreme Court, the Court has provided guidance to the district courts. " '[T]he District Court must, of course, consider whether issuance of an injunction would be warranted under ordinary principles of equity—whether breaches are occurring and *will continue*, or have been threatened and *will be committed;* whether they have caused or *will cause* irreparable injury to the employer. . . .' "[155] The emphasized language appears to address future activity, but it is unclear if this is future activity of an ongoing condition or if it is future activity of a condition that will arise at some later time. It may be loose language, or it may be tacit approval of prospective injunctions.

The Court in *Boys Markets* relied heavily upon the *Sinclair* dissent, and language in the latter opinion clearly recognized the possibility of prospective injunctions. The dissent in *Sinclair* stated:

> Under the contract and the complaint, . . . the District Court might conclude that there have occurred and will continue to occur breaches of contract of a type to which the principle of accommodation applies. It follows that rather than dismissing the complaint's request for an injunction, the Court should remand the case to the District Court with directions to consider whether to grant the relief sought—an injunction against *future repetitions.* This would entail a weighing of the employer's need for such an injunction against the harm that might be inflicted upon legitimate employee activity. It would call into question the feasibility of setting up *in futuro* contempt sanctions against the union (for striking) and against the employer (for refusing to arbitrate) in regard to *prospective disputes* which might fall more or less clearly into the adjudicated category of arbitrable grievances. In short, the District Court will have to consider with great care whether it is possible to draft a decree which would deal equitably with all the interests at stake.[156]

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[155]Boys Mkts., Inc. v. Retail Clerks Union, Local 770, 398 U.S. at 254 (quoting Sinclair Ref. Co. v. Atkinson, 370 U.S. at 228 (Brennan, J., dissenting) (emphasis added)).

[156]370 U.S. at 228-29 (emphasis added).

The Court in *Boys Markets* did not specifically address this proposition; however one must bear in mind that the *Sinclair* dissent and the *Boys Markets* opinion were both written by Justice Brennan, who stated at one point, "We have also determined that the dissenting opinion in *Sinclair* states the correct principles concerning the accommodation necessary between the seemingly absolute terms of the Norris-LaGuardia Act and the policy considerations underlying § 301(a)."[157]Thus, *Boys Markets* may be read to embrace the entire *Sinclair* dissent analysis, including the approval of prospective injunctions. However, until the Supreme Court specifically addresses the issue, there is room for conflicting interpretations as illustrated by the existing split among several circuit courts.

### *B. Seventh Circuit*

The first circuit court to address the issue was the Seventh Circuit in *Old Ben Coal v. Local 1487, UMW, (Old Ben II).*[158] The district court permanently enjoined the union based on "its finding that the union had a general policy of 'resort to self help through strikes and work stoppages which were in violation of existing labor agreements.' "[159] The union conduct occurred before and after the decree in *Old Ben I.*[160] Finding that damages were inadequate and disciplinary measures were inefficacious, the circuit court reasoned:

> In light of the frequency of the work stoppages and of the nature of the disputes, most if not all of minor dimension, it is apparent that defendants have utilized the device of work stoppages with questionable motivation and little justification. We are far from convinced that without a permanent injunction similar conduct would not continue.[161]

The court focused on the intent of *Boys Markets*, that an injunction enhances the arbitration process, and considered the Norris-LaGuardia Act, which "declares that the breadth of an injunction is to be determined by the extent of the misconduct."[162] The court concluded that "there is a proper basis for the issuance of a broad in-

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[157]398 U.S. at 249.

[158]500 F.2d 950 (7th Cir. 1974). In Old Ben Coal Corp. v. Local 1487, UMW, 457 F.2d 162 (7th Cir. 1972) (Old Ben I), although the circuit court upheld an injunction against the union, it narrowed its holding from a prospective injunction to one covering only the existing dispute. 457 F.2d at 165.

[159]500 F.2d at 952.

[160]The union had been admonished in *Old Ben I* that "[p]erhaps a broad injunction would be appropriate in some future action should it appear that the Union is unwilling to accept the present adjudication with respect to its rights." 457 F.2d at 165.

[161]500 F.2d at 952. The mere number of work stoppages was not determinative. *Id.*

[162]*Id.* at 953.

junction, given the appropriate facts."[163] The union's allegation of vagueness and lack of specificity in the order was discounted by the court because the order incorporated the specific contract language and thus required the union to do only that for which it had specifically negotiated.[164]

### *C. Tenth Circuit*

Approximately four months after *Old Ben II*, the Tenth Circuit, addressing the issue of prospective injunctions, reached the same result in *CF&I Steel Corp. v. UMW.*[165] Having considered eight strikes in the complaint, the district court found four strikes to be over issues unlikely to arise again[166] and four strikes to be over issues likely to arise again.[167] The court granted a permanent injunction against those activities in the latter group.[168] On appeal, the circuit court disposed of the union's contention that the order was impermissibly vague under Rule 65(d) of the Federal Rules of Civil Procedure:[169] "We find enjoined specific concerted activity, namely, 'strike, work stoppage, interruption of work, or picketing at the Allen mine.' These are terms of reasonably specific content in the 'common law of the shop.' . . . We find no incapacitating vagueness in the decree."[170] The court of appeals also rejected the union's position that the injunction was prohibited by the Norris-LaGuardia Act as interpreted by *Boys Markets*. After discussing the countervailing influences of the Norris-LaGuardia Act and the preference for the peaceful resolution of labor disputes by arbitration, the court, em-

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[163]*Id.*

[164]*Id.* Moreover, the court noted that the union could utilize declaratory remedies to clear up ambiguities. *Id.* at 954.

[165]507 F.2d 170 (10th Cir. 1974). The Tenth Circuit made no mention of *Old Ben I* in its decision.

[166]The issues included portal-to-portal pay, medical services, vacation pay, and hoistman's pay. *Id.* at 172.

[167]The issues included employee suspensions, employee discharges, and work assignments. *Id.*

[168]The union had argued that it was inconsistent to permanently enjoin one group but not the other. The circuit court rejected this as a "confusion of thought." *Id.* at 176.

[169]FED. R. CIV. P. 65(d) provides in pertinent part:

> Every order granting an injunction and every restraining order shall set forth the reasons for its issuance; shall be specific in terms; shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained; and is binding only upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise.

[170]507 F.2d at 173.

phasizing the future tense language in *Boys Markets*,[171] reasoned, "It is clear that the opinion [in *Boys Markets*] considered also the possibility of remedial action directed toward future conduct in a proper case. . . ."[172] The Tenth Circuit upheld the district court's accommodation between section 4 of the Norris-LaGuardia Act and section 301(a) of the Taft-Hartley Act and sustained the injunction within the permissible limits, to specific activities likely to recur.[173] The principal difference between the results achieved by the Seventh and Tenth Circuits was that the former had approved a prospective injunction as broad as the contract language while the latter's approval was limited to specific incidents with a likelihood of recurrence.

### *D. Fifth Circuit*

Less than a year later, it was the Fifth Circuit which grappled with the prospective injunction issue in *United States Steel Corp. v. UMW*.[174] The district court, after a long series of strikes and disregard for court orders, permanently enjoined the union from striking over arbitrable issues for the life of the contract. In its order, the court utilized the exact language of the contract arbitration clause to delineate the scope of arbitrable issues. A subsequent sympathy strike resulted in a contempt citation, which together with the original order was appealed.[175] The circuit court reversed, relying on its interpretation of *Boys Markets*, section 9 of the Norris-LaGuardia Act, and Rule 65(d) of the Federal Rules of Civil Procedure.[176] First, the court held that *Boys Markets*' "carefully drawn guidelines" required a "case-by-case adjudication" of whether a strike was over an arbitrable issue and, if so, whether the strike was enjoinable.[177] The court concluded that the order was overbroad and "nothing less than an injunction against striking for the life of the contract."[178] Second, the court declared that section 9 of the Norris-LaGuardia Act requires injunctions to be for "specific acts or acts as may be expressly complained of in the bill of complaint or petition filed in such case and as shall be expressly included in said findings of fact made and filed by the court. . . ."[179] Therefore, reliance

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[171] *Id.* at 176. *See* note 157 *supra*.

[172] 507 F.2d at 176.

[173] *Id.* at 177. *See* note 170 *supra*.

[174] 519 F.2d 1236 (5th Cir. 1975), *rehearing and rehearing en banc. denied*, 526 F.2d 376 (5th Cir.), *cert. denied*, 428 U.S. 910 (1976).

[175] 519 F.2d at 1238.

[176] *Id.* at 1238, 1245.

[177] *Id.* at 1245.

[178] *Id.*

[179] *Id.* at 1246 (quoting 29 U.S.C. § 109 (1976)).

upon the general language of the contract was insufficient to meet the "specific acts" requirement. Lastly, in finding that the order violated Rule 65(d) with regard to vagueness, the court rejected the employer's argument that the contract language rendered the order unambiguous. The court stated, "A collective bargaining agreement, however, is anything but a precise document; the parties themselves are often unsure of what it means."[180] Thus, the Fifth Circuit refused to recognize the use of prospective injunctions in labor disputes, where the injunction was based on broad contract language. However, the position of the Fifth Circuit in regard to prospective injunctions limited to specific acts is still an open question.[181]

### *E. Third Circuit*

The following year, the Third Circuit voiced its opinion on prospective injunctions in *United States Steel Corp. v. UMW.*[182] The district court, having issued three injunctions within a month, issued a prospective injunction as broad as the arbitration clause of the contract. The court maintained that unless restrained prospectively, the union would continue to breach its contract.[183] Although the circuit court found the *Boys Markets* holding applicable, it found error in the particular order because "[n]o finding was made . . . that the likelihood of future breaches of contract was attributable to any specific activity or lack of activity on the part of the UMW, District 5, or the officers of the Local."[184] Furthermore, the court specifically addressed the prospective nature of the injunction, summarizing the opinions of the Fifth, Tenth, and Seventh Circuits.

> Thus the Fifth Circuit seems to suggest that no injunctive relief against future violations would be proper, the Tenth Circuit holds that a prospective injunction against specifically identified types of future violations which have in the past occurred is proper, and the Seventh Circuit holds that an injunction as broad as the contract is permitted. We think that a position somewhere between the extremes is appropriate.[185]

The court stated that prospective injunctions would not run afoul of the overbreadth proscription of section 9 of the Norris-

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[180]519 F.2d at 1246. The court recognized the decisions of the Seventh and Tenth Circuits but distinguished them.

[181]In Drummond Co. v. District 20, UMW, 598 F.2d 381 (5th Cir. 1979), the court noted that the "[f]ate of single-subject prospective injunctions in this circuit, a matter of speculation after *United States Steel*, must be decided elsewhere." *Id.* at 386.

[182]534 F.2d 1063 (3d Cir. 1976).

[183]*Id.* at 1068-69.

[184]*Id.* at 1075.

[185]*Id.* at 1077.

LaGuardia Act if there is evidence of a "pattern of conduct which results in repeated and similar violations,"[186] and the court limits "injunctive relief to the likelihood of their recurrence, or to new and different kinds of violations which may be expected to occur in the future."[187] The Third Circuit considered the prospective injunction to be necessary to combat a "chronic pattern of continuing mischief"[188] which burdened the court and the parties with repeated litigation over "essentially the same issue in a slightly different context . . . ."[189] On the issue of notice and vagueness, the court declared that Rule 65(d) required that the parties be notified of specific steps that must be taken to comply with the court order.[190] Thus, the Third Circuit's position is somewhere between the extremes of the Seventh and Fifth Circuits, and although it is most analogous to the Tenth Circuit's position, it differs in certain particulars such as the Rule 65(d) effect.[191]

### *F. Ninth Circuit*

Less than two weeks after the Third Circuit's pronouncement, the Ninth Circuit added its thoughts to the evolving split. In *Donovan Construction Co. v. Construction, Production & Maintenance Laborers Union Local 383*,[192] the court stated that if a party seeking a *Boys Markets* injunction can show "a reasonable apprehension that the misconduct will recur, a hearing to determine the appropriateness of future injunctive relief is proper."[193] Under *Boys Markets*, the district court's inquiry must encompass the ordinary principles of equity;

> The difficulties of such an inquiry are naturally compounded when the court is faced with anticipated troubles rather than a present controversy. However, the complexity of this task will not deny a party access to this remedy if he can ad-

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[186] *Id.*

[187] *Id.*

[188] *Id.*

[189] *Id.*

[190] *Id.* at 1078. This differs from the Tenth Circuit which stated that the "law of the shop" rendered the broad language specific enough. CF & I Steel Corp. v. UMW, 507 F.2d 170, 173 (10th Cir. 1974) (quoting Cox, *Reflections Upon Labor Arbitration*, 72 HARV. L. REV. 1482, 1499 (1959)).

[191] Furthermore the Third Circuit addressed an issue that may have been implied in the other decisions but which was not specifically discussed, to wit, the need for the prospective order to include an order to the employer "directing compliance with the settlement of disputes clause at least as broad, and for the same period, as the injunction." 534 F.2d at 1079.

[192] 533 F.2d 481 (9th Cir. 1976).

[193] *Id.* at 484.

> duce convincing evidence that the anticipated labor dispute is sufficiently likely to occur, and that the harm threatened thereby is of such magnitude as to bring his situation within the *Boys Markets* guidelines.[194]

Thus, although the Ninth Circuit would permit prospective injunctions, the order must be accompanied by detailed factual findings that specifically identify contractual violations which have occurred in the past and are likely to recur in the future.[195]

### *G. Sixth Circuit*

The Sixth Circuit, having the benefit of five previous circuit opinions, articulated its own in *Southern Ohio Coal Co. v. UMW*.[196] After recognizing the lack of consensus among the circuits with regard to prospective injunctions and summing up their respective positions, the court took an "intermediate position."[197] Initially, the court stated, "We see nothing in *Boys Markets* that is inconsistent with a grant of prospective injunctive relief in the exercise of § 301 jurisdiction."[198]

Unlike the other circuits, the Sixth Circuit not only relied upon the future tense language of *Boys Markets* but also set forth verbatim the *Sinclair* dissent language that clearly envisioned the possibility of prospective injunctions.[199] Because the basic thrust of *Boys Markets* was the enhancement of the arbitration process, the court reasoned that a "[w]ide-scale disregard of the union's no-strike obligation . . . threatens the underpinnings of the arbitration process"[200] unless the employer has the effective immediate remedy of the prospective injunction. Joining the circuit courts that fall somewhere between the Seventh and Fifth Circuits, the Sixth Circuit held:

> Once a court has found that a union is engaged in a continuing practice of striking over arbitrable disputes and the *Boys Markets* guidelines are satisfied, we believe that the

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[194]*Id.* (citations omitted).

[195]*Id.* at 485. The court remanded the case because the factual support for the broad based injunction was insufficient. However, the circuit court acknowledged that a modification "may embrace 'any strike or work stoppage, or a threat of work stoppage' incident to a jurisdictional dispute substantially similar to that which was resolved by the May 16 arbitration award," provided sufficient record support was established. *Id.* at 486.

[196]551 F.2d 695 (6th Cir.), *cert. denied*, 434 U.S. 876 (1977)).

[197]551 F.2d at 708.

[198]*Id.*

[199]*Id.* at 708-09. *See* text accompanying note 158 *supra*.

[200]551 F.2d at 709.

> ensuing injunction may be extended to encompass future strikes over disputes similar to those which caused strikes in the past.[201]

The court left undecided the issue of whether a prospective injunction could be "as broad as the contractual arbitration clause."[202] However, the court cautioned that prospective injunctions should be drawn as narrowly as possible[203] and should be "firmly grounded on factual support in the record."[204] District courts were given the following instructions by the Sixth Circuit:

> Before an injunction may issue which grants prospective relief, the District Court should expressly find: that the present strike may be enjoined under *Boys Markets*; that the union has engaged in a pattern of strikes over arbitrable grievances that is likely to continue; that the strikes constituting the pattern of violation would warrant relief under the *Boys Markets* formula; and, that the decree is limited to specifically identified areas of dispute which have already been adjudicated and which satisfy the *Boys Markets* guidelines.[205]

The court also addressed the Rule 65(d) issue, declaring that the order should "include instructions informing the parties of specific steps they must take to prevent a recurrence of the illegal work stoppages"[206] so that the scope of the order need not be tested through contempt proceedings. Finally, like the Third Circuit, the court stated that prospective injunctions "must include an order to the employer directing him to arbitrate all grievances within the scope of the injunction."[207]

## VII. Prospective Injunctions: Relevant Considerations

The relevant considerations with respect to prospective injunctions appear to be: (1) the nature of the present dispute *vis-à-vis* the *Boys Markets* decision, (2) the existence of a pattern of the same or similar disputes and the likelihood of future recurrence, (3) the applica-

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[201] *Id.*

[202] *Id.* at 709-10 (footnote omitted).

[203] *Id.* at 710. The court noted that the overbroad injunctions run the risk of going afoul of Buffalo Forge Co. v. United Steelworkers, 428 U.S. 397 (1976).

[204] 551 F.2d at 710.

[205] *Id.* (footnote omitted).

[206] *Id.* at 711.

[207] *Id.* The court held that the preliminary injunctions issued by the district court were overbroad and failed to comport with the established guidelines of the *Boys Mkts.* opinion. *Id.*

bility of *Boys Markets* to this category of disputes, (4) the accommodation of section 4 of the Norris-LaGuardia Act to this category, (5) compliance with the substantive requirements of section 9 of the Norris-LaGuardia Act, (6) the effect of Rule 65(d), and (7) the inclusion of the employer in the order.

Five of the six circuits that have addressed the issue have found that *Boys Markets* can be read consistently with the use of prospective injunctions. The lone hold-out, the Fifth Circuit, elected to stress the narrowness of the *Boys Markets* opinion. Although recognizing that vindication of the arbitration process was at the core of the *Boys Markets* opinion, the Fifth Circuit concluded that such vindication must be established by case-by-case adjudication. The future tense language of *Boys Markets* did not convince the Fifth Circuit otherwise as they noted that such language is "in almost identical words, . . . mandated by the Norris-LaGuardia Act before any labor injunctions may issue."[208] The Fifth Circuit felt that any extension of these words to include prospective injunctions was reading "too much into this language."[209]

Such a restrained application of *Boys Markets*, while perhaps sustainable if looked at from the narrow nature of the holding, does not appear to further the overall rationale of *Boys Markets*. The other circuits have chosen to place *Boys Markets* in the larger perspective of enhancement of the arbitration process itself. *Boys Markets* cannot be read *in vacuo* but must be seen as a concomitant part of the overall process of "peaceful resolution of labor disputes." Indeed, it was the very deviance of *Sinclair* from that process that resulted in its subsequent repudiation.

A reading of *Boys Markets* to preclude prospective injunctions prohibits the realization of the decision's full potential. While a case-by-case adjudication of violations of a no-strike clause may be acceptable to resolve an existing condition, this method fails to give meaningful relief in the face of widespread disregard of such a clause. It is theoretically unobjectionable, but in the practical realities of labor disputes, it is intolerable. The circuits that allow prospective injunctions recognize the necessity of such remedial devices in the arbitration process. Furthermore, the language in *Boys Markets* does not specifically prohibit prospective injunctions and, despite a narrow holding, would conversely appear to encourage them. The *Boys Markets* opinion is the definitive accommodation of section 4 of the Norris-LaGuardia Act and section 301(a) of the Taft-Hartley Act;

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[208]United States Steel Corp. v. UMW, 519 F.2d at 1245 n.17. *See* Norris-LaGuardia Act, § 7(a), 29 U.S.C. § 107(a) (1976).

[209]519 F.2d at 1245 n.17.

courts have correctly extended its guidance and rationale to prospective situations.

Having resolved the question of the applicability of *Boys Markets* to future violations, the courts had to determine if the orders complied with the mandates of section 9 of the Norris-LaGuardia Act[210] and Rule 65(d).[211] Although these two provisions appear to address the same category of defects, lack of specificity, the former is directed against the substantive problem of overbreadth while the latter concerns the procedural defect of vagueness.[212]

Section 9 of the Norris-LaGuardia Act obviously must be accommodated,[213] although to a lesser extent than section 4 of the same Act. However, as the Sixth Circuit has indicated, section 9 "still requires a court to issue the narrowest possible injunction necessary to effectively safeguard the plaintiff's rights."[214] The "express findings of fact" requirement of section 9 of the Norris-LaGuardia Act can be satisfied if the court expressly finds that specific violations of the no-strike clause have occurred in the past and are likely to recur in the future. The record should indicate the specific violations and predictions about future violations should be reasonable.

The Fifth Circuit, in addition to its unwillingness to interpret *Boys Markets* to include prospective injunctions, also held that failure to allege a *specific* act in the complaint was unsupportable under section 9 of the Norris-LaGuardia Act.[215] However, if specific acts were complained of, the Fifth Circuit may have taken a different view of the applicability of section 9.[216] The point that gave rise to the overbreadth concern in the other circuits was whether the language of the order could be as broad as the arbitration agreement. Only the Seventh Circuit has gone this far.[217] The remaining circuits fear that blanket injunctions may present an unacceptable

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[210]Norris-LaGuardia Act, § 9, 29 U.S.C. § 101 (1976).

[211]*See* note 172 *supra*.

[212]The court noted that vagueness and overbreadth are distinct concepts:

> Analytically, the broadness of an injunction refers to the range of proscribed activity, while vagueness refers [to] the particularity with which the proscribed activity is described. Developments in the Law—Injunctions, 78 HARV. L. REV. 994, 1064 (1965). "Vagueness" is a question of notice, i.e., procedural due process, and "broadness" is a matter of substantive law. *See* Wright & Miller, Federal Practice & Procedure 2953 at 546-47 (1973).

Southern Ohio Coal Co. v. UMW, 551 F.2d 695, 705 n.11 (6th Cir.), *cert. denied*, 434 U.S. 876 (1977) (quoting United States Steel Corp. v. UMW, 519 F.2d 1236, 1246 n.19 (5th Cir. 1975)).

[213]551 F.2d at 709.

[214]*Id. Accord*, International Ass'n of Machinists v. Street, 367 U.S. 740 (1961).

[215]519 F.2d at 1246.

[216]*See* Drummond Co. v. District 20, UMW, 598 F.2d at 386.

[217]Old Ben Coal Corp. v. Local 1487, UMW, 500 F.2d 950 (7th Cir. 1974).

risk of excessive judicial entanglement.[218] The issuance of an injunction, based upon the arbitration clause language of the contract, would create a drastic shift in the economic power balance between employers and unions. Instead of fostering arbitration, it may result in excessive employer reliance upon contempt proceedings instead of the arbitration process. The court should avoid this result which is obviously counterproductive to the entire purpose of the national policies. The procedure which safely accommodates section 9 to these policies is for the court to make specific findings of fact on violations that have occurred, determine if they meet the *Boys Markets* criteria, identify the likelihood of their recurrence or that of analogous violations, and limit the scope of the order to those areas.

Attacks on prospective injunctions based on Rule 65(d) center around the adequacy of notice that has been given to allow the party to know in advance what actions will violate the order. They are premised on procedural due process requirements and efforts of the courts have been to compel compliance. The union should have fair notice of the prohibited scope of activities and should not have to test the parameters of the order in contempt proceedings.[219] This again raises questions concerning the feasibility of drafting an order as broad as the arbitration clause. Often, unions may be unable to comply with such an indefinite standard. Many disputes are not clearly definable as arbitrable or nonarbitrable as evidenced by the frequency with which this issue arises even in arbitration proceedings. A court which limits its order to specifically identified violations with steps that the union must take to comply, should easily meet the Rule 65(d) requirements.[220] However, the converse is not necessarily true; that is, an order drafted in the arbitration clause language is not always in noncompliance with Rule 65(d). If a union has an established history of disregarding its contractual obligations, the court should be allowed to draft an order that is sufficiently broad to meet this contingency. This is not to advocate blanket injunctions but is a realization of the practical difficulties that often occur in declaring certain activities as being within a particular category. If the order had to be overly specific, a union could attempt to circumvent it by pointing to minute distinctions between its present act and the prohibited category. Courts should be given enough flexibility to deal with the realities of labor disputes and draft an order which recognizes the interests of both parties as well as the national labor policy. Thus, so long as the court describes "in reasonable detail"

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[218] *See, e.g.*, 551 F.2d at 710.

[219] *See* United States Steel Corp. v. UMW, 534 F.2d at 1078.

[220] *Id.*

the scope of the prohibited acts, Rule 65(d) can be complied with in the issuance of prospective injunctions.

The extent to which Rule 65(d) allows or limits broad language was addressed in *United States Steel Corp. v. UMW*,[221] wherein its was stated:

> A union should not be allowed to escape injunctive restraints merely because the range of previous violations by its members defies categorization. The injunction "should be broad enough to prevent evasion." *Local 167 v. United States*, 291 U.S. 293, 299, 54 S.Ct. 396, 399, 78 L.Ed. 804, 810 (1934), *cited with approval in May Stores Co. v. Labor Board*, 326 U.S. 376, 391, n.13, 66 S.Ct. 203, 212, 90 L.Ed. 145, 157 (1945). When past violations may be reasonably categorized, the order should do so. *See CF&I, supra*, 507 F.2d at 173. When, however, the pattern of past conduct does not readily lend itself to such treatment, I see no objection to the use of carefully considered language broadly restraining strikes over arbitrable grievances, especially if it can be joined with specific language to provide effective relief. *See May Stores Co. v. Labor Board*, 326 U.S. at 391, 66 S.Ct. at 212, 90 L.Ed. at 157.

As a procedural safeguard, the union should have available the declaratory relief process to eradicate doubtful situations.

To keep the arbitration process functioning properly, the court should, of course, include as part of its order a requirement compelling the employer to arbitrate that is as broad as the order to the union not to strike. While only the Third and Sixth Circuits have specifically addressed the issue,[222] it is clear from the entire rationale of the accommodation process that this requirement should be mandatory. Otherwise, the employer would have a tremendous weapon without any compensating obligations. Employers could use the prospective injunction to harass the union. Also, without such an order, the employer has no incentive to arbitrate because he can take unilateral action and indefinitely delay compliance with his contractual obligation to arbitrate, so long as the union via the prospective injunction could not retaliate with a strike.

## VIII. Conclusion

The injunction, a distinctly equitable remedy,[223] plays an important, sometimes outcome determinative, role in labor disputes.

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[221] *Id.* at 1083 (Rosenn, J., concurring).

[222] *See* notes 190 & 207 *supra*.

[223] In Truly v. Wanzer, 46 U.S. (5 How.) 141 (1847) the Court stated, "There is no power, the exercise of which is more delicate, which requires greater caution, delibera-

Whenever an injunction is issued in a labor dispute, no matter how narrowly drafted by the court, there is a critical alteration in the balance of power in the economic struggle between the employer and the union. If such an injunction has prospective application, the alteration is drastic. Nevertheless, although prospective injunctions have social desirability as labor policy, the circuit courts, have been acutely aware of their potential abuses. Thus, a majority of the courts have allowed prospective injunctions, but have set stringent guidelines to insure their proper use.

Labor disputes are complex affairs. To maintain economic equilibrium, injunctions, particularly prospective injunctions, should not be used to provide an easy solution. The arbitration agreement coupled with a no-strike clause, supported by Congress and the judiciary, has evolved as the preferred method of peaceful resolution of labor disputes,[224] as is evidenced by the entire accommodation process between section 4 of the Norris-LaGuardia Act and section 301(a) of the Taft-Hartley Act. So long as courts, recognizing that labor disputes are not of comparable simplicity, continue in the direction of the Sixth Circut,[225] the prayer of the Third Circuit[226] for a definitive resolution by the Supreme Court, should be answered affirmatively in favor of prospective injunctions.

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tion and sound discretion, or more dangerous in a doubtful case, than the issuing of an injunction. It is the strong arm of equity. . . ." *Id.* at 142.

[224]*See, e.g.*, United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960).

[225]*See* Southern Ohio Coal Co. v. UMW, 551 F.2d 695 (6th Cir.), *cert. denied*, 434 U.S. 876 (1977), wherein the court stated, "[G]ranting prospective injunctive relief in appropriate cases is consistent with the accommodation reached in *Boys Mkts.* between the policies of the Norris-LaGuardia Act and the public policy encouraging peaceful settlement of labor disputes through arbitration." *Id.* at 709.

[226]In United States Steel Corp. v. UMW, 534 F.2d 1063 (3d Cir. 1976), the court stated, "Only the Supreme Court is in position to resolve this conflict . . . . The issue of injunctive relief with respect to future violations of implied no strike agreements is of such importance that we prefer to take no step that might delay a petition for certiorari." *Id.* at 1085.

# Notes

## The Business Judgment Rule and the Litigation Committee: The End of a Clear Trend in Corporate Law

### I. INTRODUCTION

The time-honored business judgment rule has foiled many shareholder challenges to their directors' business decisions.[1] However, if self-dealing, bad faith, or lack of due care tainted the directors' decision, the shareholder could summon the courts' aid.[2] A board's refusal to pursue a corporate cause of action historically would not block a shareholder's derivative suit naming a majority of the board as wrongdoers.[3] Recently, however, corporations have persuaded federal courts to dismiss shareholder derivative actions if a committee composed of ostensibly disinterested directors decides, in its good faith business judgment, to terminate the suit.[4]

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[1]The business judgment rule's origin coincided with the industrial growth of the latter portion of the nineteenth century. *See* Briggs v. Spaulding, 141 U.S. 132 (1891); Witters v. Sowles, 31 F. 1 (C.C.D. Vt. 1887); Spering's Appeal, 71 Pa. 11 (1872); Hodges v. New England Screw Co., 1 R.I. 312 (1850); Note, *The Continuing Viability of the Business Judgment Rule as a Guide for Judicial Restraint*, 35 GEO. WASH. L. REV. 562, 565-66 (1967) (finding the rule parallel to the economic policy of laissez-faire).

[2]*See* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917); Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980); Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Issner v. Aldrich, 254 F. Supp. 696 (D. Del. 1966); Gottlieb v. Heyden Chem. Corp., 90 A.2d 660 (Del. 1952); Guth v. Loft, 5 A.2d 503 (Del. 1939); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980). *See also* text accompanying notes 55-70 *infra*.

[3]United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 264 (1917); Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455, 461 (1903); Hawes v. City of Oakland, 104 U.S. 450, 460 (1881); Galef v. Alexander, 615 F.2d 51, 61-62 (2d Cir. 1980); Ash v. International Bus. Mach., Inc., 353 F.2d 491, 493 (3d Cir. 1965), *cert. denied*, 384 U.S. 927 (1966); Swanson v. Traer, 249 F.2d 854, 858 (7th Cir. 1957); Nussbacher v. Chase Manhattan Bank, 444 F. Supp. 973, 977 (S.D.N.Y. 1977); Issner v. Aldrich, 254 F. Supp. 696, 701 (D. Del. 1966).

[4]Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979); Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980); Seigal v. Merrick, No. 74-2475 (S.D.N.Y. Dec. 20, 1979); Rosengarten v. International Tel. & Tel. Corp., 466 F. Supp. 817 (S.D.N.Y. 1979); Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979); Parkoff v. General Tel. & Elec. Corp., 425 N.Y.S.2d 599 (App. Div. 1980); Falkenberg v. Baldwin, N.Y.L.J., Mar. 3, 1980, at 12, col. 6 (Sup. Ct. 1980); Wallenstein v. Warner, N.Y.L.J., May 9, 1978, at 11, col. 6 (Sup. Ct. 1978); Auerbach v. Aldrich, N.Y.L.J., Dec. 23, 1977, at 13, col. 5 (Sup. Ct. 1977); Levy v. Sterling Drug, Inc., N.Y.L.J., Nov. 23, 1977, at 10, col. 2 (Sup. Ct. 1977). *Contra*, Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980). *See also* text accompanying notes 74-143 *infra*.

This Note will review the traditional application of the business judgment rule as a defense for inexpedient business decisions and the rule's counterpart, the intrinsic fairness test.[5] An examination of the "special litigation committee"[6] cases will also be made, in light of the disparate results reached in three suits against Zapata Corporation.[7] Finally, this Note will discuss the ramifications of the litigation committee cases and the Zapata decisions.

## II. THE BACKGROUND OF THE BUSINESS JUDGMENT RULE

Corporation law places the management of corporate affairs under the direction of the board of directors.[8] The courts recognized the necessity of an unfettered decision-making environment and developed the business judgment rule to effectuate the directors' exercise of discretion in management.[9] Broadly stated, the business judgment rule provides that "the law will not hold directors liable for honest errors, for mistakes of judgment, when they act without corrupt motive and in good faith, that is, for mistakes which may properly be classified under the head of honest mistakes."[10]

Some commentators perceive the business judgment rule to be incorporated into the statement of director duties posited by section 35 of the Model Business Corporation Act.[11] Section 35 provides:

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[5]*See* text accompanying notes 55-70 *infra.*

[6]*Id.* The committees are designated with various titles. For convenience, the general description "litigation committee" will be used.

[7]Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980). Zapata is a Delaware corporation.

[8]DEL. CODE ANN. tit. 8, § 141(a) (Supp. 1980); N.Y. BUS. CORP. LAW § 701 (McKinney Supp. 1980-1981). *See generally* ABA-ALI MODEL BUS. CORP. ACT ANN. 2d § 35 (Supp. 1977); N. LATTIN, THE LAW OF CORPORATIONS § 69 (2d ed. 1971).

[9]*See, e.g.*, Galef v. Alexander, 615 F.2d 51, 57 (2d Cir. 1980); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 274 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979); 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 1039, at 37-38 (perm. ed. 1975); ABA, *Corporate Director's Guidebook*, 33 BUS. LAW. 1595, 1604 (1978) [hereinafter cited as ABA].

[10]3A W. FLETCHER, *supra* note 9, at 37; *see* H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 242, at 482 (2d ed. 1970); N. LATTIN, *supra* note 8, § 78, at 272-73; ABA, *supra* note 9, at 1604; Note, *The Continuing Viability of the Business Judgment Rule as a Guide for Judicial Restraint*, 35 GEO. WASH. L. REV. 562, 562-63 (1967); Comment, *The Business Judgment Rule: A Guide to Corporate Directors' Liability*, 7 ST. LOUIS U.L.J. 151 (1962).

[11]ABA, *supra* note 9, at 1632; Arsht, *Fiduciary Responsibilites of Directors, Officers and Key Employees*, 4 DEL. J. CORP. L. 652, 662 (1979). *See also* Veasey, *Directors' Standard of Care Under Section 35 of the Model Business Corporation Act*, 4 DEL. J. CORP. L. 665 (1979).

> A director shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances.[12]

In other words, as long as the director remains within the boundaries of conduct traced by the section 35 standard, the business judgment rule will be available as a defense to charges of liability for injuries sustained by the corporation and its shareholders.[13]

In addition to exercising good faith and due care, a director must fulfill a fiduciary duty before he comes within the protection of the business judgment umbrella.[14] The Delaware Supreme Court provided a universally recognized definition of that fiduciary duty in *Guth v. Loft*:[15]

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests

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[12]ABA-ALI MODEL BUS. CORP. ACT ANN. 2d § 35 (Supp. 1977).

[13]ABA, *supra* note 9, at 1632; Arsht, *supra* note 11, at 660.

[14]United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917); Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455 (1903); Hawes v. City of Oakland, 104 U.S. 450 (1881); Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Ash v. International Bus. Mach., Inc., 353 F.2d 491 (3d Cir. 1965), *cert. denied*, 384 U.S. 927 (1966); Stadin v. Union Elec. Co., 309 F.2d 912 (8th Cir. 1962), *cert. denied*, 373 U.S. 915 (1963); Nussbacher v. Chase Manhattan Bank, 444 F. Supp. 973 (S.D.N.Y. 1977); Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976); Bernstein v. Mediobanca Banca di Credito Finanziario-Societa Per Azioni, 69 F.R.D. 592 (S.D.N.Y. 1974); Klotz v. Consolidated Edison Co., 386 F. Supp. 577 (S.D.N.Y. 1974); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970); Warshaw v. Calhoun, 221 A.2d 487 (Del. 1966); Gottlieb v. Heyden Chem. Corp., 90 A.2d 660 (Del. 1952); Bodell v. General Gas & Elec. Corp., 140 A. 264 (Del. 1927); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980). W. FLETCHER, *supra* note 9, at 38; H. HENN, *supra* note 10, at 483; N. LATTIN, *supra* note 8, § 78, at 272-73. *See generally* Guth v. Loft, 5 A.2d 503 (Del. 1939); Gottlieb v. McKee, 34 Del. Ch. 537, 107 A.2d 240 (1954); Lewis, *The Business Judgment Rule and Corporate Directors' Liability for Mismanagement*, 22 BAYLOR L. REV. 157, 160-61 (1970).

[15]5 A.2d 503 (Del. 1939).

> of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.[16]

Hence, "[b]usiness judgment . . . , by definition, presupposes an honest, unbiased judgment (compliance with fiduciary duty) reasonably exercised (due care), and compliance with other applicable requirements."[17] As a defensive rule, the business judgment doctrine insulates the directors from personal liability unless the complaining shareholder is able to rebut the presumption that the directors have fulfilled all of their duties.[18]

The business judgment rule has also been characterized as a standard for judicial review.[19] As a judicial guidepost, the "rule will be applied only when an objective evaluation of the context surrounding a decision indicates that forces influencing the judgment of the decision-makers uniformly tended to motivate a decision for the benefit of all shareholders."[20] However framed, the rule provides directors with a sanctuary where they may exercise uninhibited corporate discretion unless self-dealing, bad faith, or lack of due care[21] breach the rule's presidio.[22]

### *A. Public Policy Considerations*

The protection afforded by the business judgment rule is well supported by several policy arguments. First, the courts, especially

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[16]*Id.* at 510.

[17]H. HENN, *supra* note 10, at 483.

[18]*See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); Warshaw v. Calhoun, 221 A.2d 487, 493 (Del. 1966); ABA, *supra* note 9, at 1604. *See generally* cases cited note 2 *supra*; text accompanying notes 27-53 *infra*.

[19]Note, *The Continuing Viability of the Business Judgment Rule as a Guide for Judicial Restraint*, 35 GEO. WASH. L. REV. 562 (1967).

[20]*Id.* at 564. The author based his view on Judge Shientag's statement: "The 'business judgment rule' . . . yields to the rule of undivided loyalty." Bayer v. Beran, 49 N.Y.S.2d 2, 6 (Sup. Ct. 1944).

[21]Although due care implies a negligence standard, the courts rarely hold directors liable for mere negligence. *See* Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968) ("The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack."). *See, e.g.*, Selheimer v. Manganese Corp. of America, 423 Pa. 563, 224 A.2d 634 (1966).

[22]ABA, *supra* note 9, at 1604; Arsht, *supra* note 11, at 660; Lewis, *supra* note 14, at 172. *See also* text accompanying notes 27-53 *infra*.

when deluded by hindsight, are often "ill equipped" to pass judgment on complex business decisions.[23] Second, imposition of liability for honest errors in judgment might stifle entrepreneurial risk-taking and chill board meetings.[24] Third, the directors do not hold themselves out as insurers of the corporation's success; consequently, it would be unfair to impose liability upon directors for set-backs when the directors have fulfilled their duties to the corporation.[25] Finally, state law puts the responsibility of management upon the board of directors elected by the shareholders and not upon a judicial system which is wholly unaccountable to the corporation and its shareholders.[26] To effectuate corporate goals, the corporate policy-making atmosphere must be free from judicial and shareholder interference. Shareholders, however, must be able to seek the courts' assistance when directors act in derogation of the best interests of the corporation and its shareholders.

### *B. The Burden of Proof*

Most courts place upon the plaintiff-shareholder the burden of proving that a director's decision does not warrant the protection of the business judgment rule defense.[27] In *Ash v. International*

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[23]Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 274-75 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979); ABA, *supra* note 9, at 1604; *See* Lewis, *supra* note 14, at 171-72.

[24]Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 274 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Bayer v. Beran, 49 N.Y.S.2d 2, 6 (Sup. Ct. 1944); ABA, *supra* note 9, at 1603-04; Dyson, *The Director's Liability for Negligence*, 40 IND. L.J. 341, 367 (1965); Ward, *Fiduciary Standards Applicable to Officers and Director's and the Business Judgment Rule Under Delaware Law*, 3 DEL. J. CORP. L. 244, 245 (1978); Note, *supra* note 1, at 565.

[25]*See* H. HENN, *supra* note 10, at 482-83; N. LATTIN, *supra* note 8.

[26]Lewis, *supra* note 14, at 158, 171-72. *See generally* statutes cited note 8 *supra*.

[27]United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Ash v. International Bus. Mach., Inc., 353 F.2d 491 (3d Cir. 1965), *cert. denied*, 384 U.S. 927 (1966); Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976); Bernstein v. Mediobanca Banca di Credito Finanziario-Societa Pre Azioni, 69 F.R.D. 592 (S.D.N.Y. 1974); Klotz v. Consolidated Edison Co., 386 F. Supp. 577 (S.D.N.Y. 1974); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970); Wolfensohn v. Madison Fund, Inc., 253 A.2d 72 (Del. 1969); Warshaw v. Calhoun, 221 A.2d 487 (Del. 1966); Marks v. Wolfson, 188 A.2d 680 (Del. 1963); Bodell v. General Gas & Elec. Corp., 140 A. 264 (Del. 1927); Gimbel v. Signal Co., 316 A.2d 599 (Del. Ch. 1974); Puma v. Marriott, 283 A.2d 693 (Del. Ch. 1971); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Davis v. Louisville Gas & Elec. Co., 16 Del. Ch. 157, 142 A. 654 (1928). *See* Arsht, *supra* note 11, at 661-62; Lewis, *supra* note 14, at 172; Ward, *supra* note 24, at 245; Note, *supra* note 1, at 562. *See generally* ABA, *supra* note 9, at 1604.

*Business Machines, Inc.*,[28] the United States Court of Appeals for the Third Circuit held that

> [a] stockholder's derivative action . . . can be maintained only if the stockholder shall allege and prove that the directors of the corporation are personally involved or interested in the alleged wrongdoing in a way calculated to impair their exercise of business judgment on behalf of the corporation, or that their refusal to sue reflects bad faith or breach of trust in some other way.[29]

The Delaware courts use such language as "fraud or gross overreaching,"[30] "bad faith or abuse of discretion,"[31] "fraud, misconduct, or abuse of discretion,"[32] "profited at the expense of the corporation,"[33] and "improper motive . . . or a reckless indifference to or a deliberate disregard of the stockholders"[34] to describe what the plaintiff must allege and show to overcome the business judgment defense. Finding this language overbroad,[35] one commentator, after reviewing the Delaware decisions holding the business judgment rule inapplicable, found that the shareholder could circumvent the defense by showing:

> (1) that the directors did not exercise due care to ascertain the relevance of the available facts before voting to authorize the transaction; or (2) that the directors voted to authorize the transaction even though they could not have reasonably believed the transaction to be for the best interest of the corporation; or (3) that in some other way the directors' authorization of the transaction was not in good faith.[36]

Not surprisingly, these conditions encompass the directors' duties imposed by section 35 of the Model Business Corporation Act.[37]

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[28]353 F.2d 491 (3d Cir. 1965).

[29]*Id.* at 493. *See also* Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455 (1903); Klotz v. Consolidated Edison Co., 386 F. Supp. 577 (S.D.N.Y. 1974).

[30]Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971).

[31]Warshaw v. Calhoun, 221 A.2d 487, 493 (Del. 1966).

[32]Kors v. Carey, 39 Del. Ch. 47, 54, 158 A.2d 136, 140 (1960).

[33]Maldonado v. Flynn, 413 A.2d 1251, 1256 (Del. Ch. 1980). *See also* Issner v. Aldrich, 254 F. Supp. 696, 700 (D. Del. 1966) ("helping themselves financially at the expense of the corporation").

[34]Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 325, 147 A. 257, 261 (1929).

[35]Arsht, *supra* note 11, at 655.

[36]*Id.* at 660. *See also* Lewis, *supra* note 14, at 172.

[37]Arsht argues that Delaware's business judgment rule is incorporated into section 35. Arsht, *supra* note 11, at 662. Arsht reasons that "the key issue is whether the directors, officers or controlling stockholders have complied with the legal standards

Exactly what facts the shareholder must bring forth to pierce the rule's shield is not always clearly articulated by the courts.[38] Illustrative of the shareholder's predicament is the Delaware decision in *Chasin v. Gluck*.[39] *Chasin* involved a parent-subsidiary relationship in which the defendant, Gluck, by stock ownership, dominated the entire board of the parent, Grayson.[40] Gluck used his position to control eight[41] of the twelve directors of the subsidiary, Beck.[42] Beck rented space in Grayson stores in return for a percentage of Beck's sales.[43] The terms of the lease provided for Grayson employees to sell the Beck products, to commingle Beck receipts with Grayson receipts, and to remit Beck's portion of the receipts on a monthly basis.[44] Beck allowed Grayson's indebtedness to accumulate to $233,856.76 over eight months because of Grayson's financial difficulties.[45] After Grayson went into bankruptcy, shareholder Chasin brought a derivative suit claiming that the directors breached their fiduciary duty to Beck by not demanding timely debt payments when their dual capacities as directors in both firms should have given them knowledge of Grayson's precarious financial state.[46] Defendant claimed that he merely used good business judgment to help Grayson through its financial trauma and thus secure Grayson's equity in Beck.[47] Evidence showed that Gluck had personally guaranteed a $4,200,000 loan to the faltering Grayson company and had full knowledge of Grayson's financial crisis.[48]

Conceding that "Gluck could no doubt have hoped to be personally benefited as a result of the transactions complained of through reduction of his personal liability on his guarantees of Grayson debts . . .,"[49] the court found no direct evidence of Gluck's culpability despite his domination of both boards, his personal

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which the courts apply to determine whether directors have properly performed their duties. If they have met those standards, the court will not enjoin the transaction or hold them liabile." *Id.* at 660 (footnotes omitted).

[38]*See* Issner v. Aldrich, 254 F. Supp. 696 (D. Del. 1966); Findley v. Garrett, 109 Cal. App. 2d 166, 240 P.2d 421 (1952); Chasin v. Gluck, 282 A.2d 188 (Del. Ch. 1971). *See generally* text accompanying notes 39-53 *infra*.

[39]282 A.2d 188 (Del. Ch. 1971).

[40]*Id.* at 189.

[41]Seven of the Beck directors were also Grayson directors. *Id.*

[42]*Id.*

[43]*Id.* at 190.

[44]*Id.*

[45]*Id.*

[46]*Id.*

[47]*Id.* at 191.

[48]*Id.*

[49]*Id.* at 192.

knowledge of the financial problems, and his guarantee of Grayson loans.[50] The court held:

> [T]he mere fact that interlocking directors are involved in an intercorporate transaction does not of itself cause the higher burden of proof called for under such rule to shift to the party sought to be charged with accountability. In other words, self-dealing on the part of a dominant fiduciary must first be established in order for the intrinsic fairness rule to be successfully invoked . . . .[51]

Not only did the court find the shareholder's evidence inadequate to show self-dealing,[52] but the evidence was also deemed insufficient to show "bad faith, negligence, or gross abuse of discretion, the type of conduct looked for when a non-self-dealing fiduciary is sought to be charged with responsibility for corporate losses injurious to minority stockholders."[53]

### C. *The Intrinsic Fairness Test*

If a shareholder's challenge survives the burden and pleading pitfalls[54] surrounding the business judgment rule defense, the counterpart of the business judgment rule, the intrinsic fairness test, may be invoked by the courts.[55] This test is invoked because

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[50]*See* text accompanying notes 40-41, 48 *supra.*

[51]282 A.2d at 192.

[52]*Id.* at 193.

[53]*Id.*

[54]The complaining shareholder not only must convince the court that the directors have breached their duties to the corporation and its shareholdes but also must produce evidence sufficient to show active self-dealing, bad faith, or lack of due care. *See* text accompanying notes 27-53 *supra.*

[55]Teren v. Howard, 322 F.2d 949 (9th Cir. 1963) (stock options and waste) (deciding Delaware law); Harriman v. E.I. DuPont de Nemours & Co., 411 F. Supp. 133 (D. Del. 1975); Michelson v. Duncan, 407 A.2d 211 (Del. 1979) (stock option plan); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970); Cheff v. Mathes, 199 A.2d 548 (Del. 1964) (perpetuation of control); Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952); Gottlieb v. Heyden Chem. Corp., 90 A.2d 660 (Del. 1952) (stock option); Keenan v. Eshleman, 2 A.2d 904 (Del. 1938); Tanzer v. International Gen. Indus., Inc., 402 A.2d 382 (Del. Ch. 1979); Schreiber v. Bryan, 396 A.2d 512 (Del. Ch. 1978); Kemp v. Angel, 381 A.2d 241 (Del. Ch. 1977); Palley v. McDonnell Co., 295 A.2d 762 (Del. Ch. 1972), *aff'd sub nom.* McDonnell Douglas Corp. v. Palley, 310 A.2d 635 (Del. 1973); Theodora Holding Corp. v. Henderson, 257 A.2d 398 (Del. Ch. 1969) (personal loan); Bastian v. Bourns, Inc., 256 A.2d 680 (Del. Ch. 1969), *aff'd,* 278 A.2d 467 (Del. 1970); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Porges v. Vadsco Sales Corp., 27 Del. Ch. 127, 32 A.2d 148 (1943). *See generally* Nathan & Shapiro, *Legal Standard of Fairness of Merger Terms Under Delaware*

"when the persons, be they stockholders or directors, who control the making of a transaction and the fixing of its terms, are on both sides, then the presumption and deference to sound business judgment are no longer present. Intrinsic fairness, tested by all relevant standards, is then the criterion."[56] As described in *Chasin v. Gluck*,[57] if the shareholder can show self-dealing, "bad faith, negligence, or gross abuse of discretion,"[58] the burden of proof "shifts to the defendants to show the entire fairness of the transaction under the careful watch of the courts."[59]

Most cases involving the intrinsic fairness test concern parent-subsidiary relationships such as mergers[60] or corporate opportur ..y.[61] Before scrutinizing the transaction, however, the courts require the shareholder to show the parent's domination and self-dealing.[62] Once these requirements are fulfilled, the directors may not avail themselves of the business judgment rule defense,[63] and they must shoulder the burden of showing the entire fairness of the transaction.[64] The standard used to gauge the fairness of parent-subsidiary transactions requires "that the transaction between the two be reached as though each had in fact exerted its bargaining power against the other at arm's length."[65]

Of more interest are those cases involving stock option plans tainted by self-dealing. In *Gottlieb v. Heyden Chemical Corp.*,[66] the

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*Law*, 2 DEL. J. CORP. L. 44 (1977) (describing the business judgment rule and intrinsic fairness test as mutually exclusive extremes on a continuum).

[56]David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 430-31 (Del. Ch. 1968). *See* cases cited note 55 *supra*.

[57]282 A.2d 188 (Del. Ch. 1971).

[58]*Id.* at 193.

[59]Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978).

[60]*See, e.g.*, Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979); Tanzer v. International Gen. Indus., Inc., 402 A.2d 382 (Del. Ch. 1979); Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978); Bastian v. Bourns, Inc., 256 A.2d 680 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970); Porges v. Vadsco Sales Corp., 27 Del. Ch. 127, 32 A.2d 148 (1943).

[61]*See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970); Guth v. Loft, 5 A.2d 503 (Del. 1939); Gottlieb v. McKee, 34 Del. Ch. 537, 107 A.2d 240 (1954).

[62]Harriman v. E.I. DuPont de Nemours & Co., 411 F. Supp. 133, 152 (D. Del. 1975); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970); Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978); Chasin v. Gluck, 282 A.2d 188, 192 (Del. Ch. 1971); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 430-31 (Del. Ch. 1968).

[63]David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 430-31 (Del. Ch. 1968). *See generally* cases cited note 62 *supra*.

[64]Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978). *See generally* cases cited note 62 *supra*; Arsht, *supra* note 11, at 663; Ward, *supra* note 24, at 245.

[65]Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 886 (Del. 1970).

[66]90 A.2d 660 (Del. 1952).

directors instituted a stock option plan where "key employees" and the directors themselves received valuable options for no consideration.[67] The Delaware Chancery Court held that

> [w]here a majority of the directors representing the corporation are conferring benefits upon themselves out of assets of the corporation, we do not understand that rule [business judgment rule] to have any application whatever. Human nature being what it is, the law, in its wisdom, does not presume that directors will be competent judges of the fair treatment of their company where fairness must be at their own personal expense. In such a situation the burden is upon the directors to prove not only that the transaction was in good faith, but also that its intrinsic fairness will withstand the most searching and objective analysis.[68]

The *Gottlieb* standard of fairness requires "the directors to prove that the bargain had in fact been at least as favorable to the corporation as they would have required if the deal had been made with strangers . . . ."[69] Thus, a situation involving self-dealing directors strips away the business judgment defense and exposes the director to the harsher "stranger" standard of the intrinsic fairness test.[70]

In summary, the business judgment rule is traditionally used as a defense to liability arising from mistakes in good faith business judgment which result in harm to the corporation and its shareholders.[71] The challenging shareholder must rebut the presumption that the directors have fulfilled all of their duties to the corporation and its shareholders before the courts will scrutinize the transaction.[72] Once the business judgment defense is circumvented, however, the directors have the burden of showing the entire fairness of the undertaking.[73]

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[67]*Id.* at 663.

[68]*Id.*

[69]*Id.*

[70]Cohen v. Ayers, 596 F.2d 733 (7th Cir. 1979); Teren v. Howard, 322 F.2d 949 (9th Cir. 1963); Michelson v. Duncan, 407 A.2d 211 (Del. 1979); Gottlieb v. Heyden Chem. Corp., 90 A.2d 660 (Del. 1952); Rosenthal v. Burry Biscuit Corp., 60 A.2d 106 (Del. 1948). *See* Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980). *Contra*, Udoff v. Zipf, 58 A.D.2d 533, 395 N.Y.S.2d 462 (Sup. Ct. 1977). *See generally* Beard v. Elster, 160 A.2d 731 (Del. 1960); Kerbs v. California Eastern Airways, Inc., 32 Del. Ch. 219, 83 A.2d 473 (1951).

[71]*See* text accompanying notes 8-18 *supra* (this protection is available providing, of course, that the director has fulfilled all of his duties to the corporation and its shareholders); H. HENN, *supra* note 10, at 483.

[72]*See* cases cited note 27 *supra*; text accompanying notes 27-53 *supra*.

[73]*See* cases cited note 55 *supra*; text accompanying notes 55-70 *supra*.

## III. THE LITIGATION COMMITTEE

### *A. The Committee Technique*

Since 1976,[74] shareholders have encountered an even more formidable obstacle to their challenges of director impropriety than was presented by the traditional business judgment defense. Now when a shareholder brings a derivative action[75] in a federal court,[76] corporate directors are attempting to insulate themselves from personal liability by appointing a "special litigation committee"[77] ostensibly composed of disinterested directors.[78] The committee is empowered to determine, in its business judgment, whether the shareholder's derivative suit should proceed or be terminated. Federal courts have ruled that the business judgment rule removes the committee's determination from judicial interference and have dismissed the derivative actions unless the shareholders have been able to show that the committee lacked independence or conducted

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[74]Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976). *Gall* seems to be the first federal decision involving the special litigation committee technique to insulate corporate directors from personal liability.

[75]A shareholder's derivative action is a suit brought by a shareholder on behalf of the corporation. The corporation, not the individual shareholder, owns the cause of action. The board of directors, hence, properly control the suit, as a corporate right. The derivative action allows a shareholder to assert a corporate claim "[w]hen the corporate cause of action is for some reason not asserted by the corporation itself . . . ." H. HENN, *supra* note 10, § 360, at 756. Justice Jackson described the derivative suit as "the chief regulator of corporate management." Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949). *See generally*, FED. R. CIV. P. 23.1; Note, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168 (1976).

[76]Shareholders are taking derivative suits to federal courts for several reasons. Primarily, shareholders perceive state court as too permissive of director misconduct. *See, e.g.*, Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 666 (1974) (Delaware has "watered the rights of shareholders vis-a-vis management down to a thin gruel."). The Federal Rules of Civil Procedure provide the shareholder with more amenable discovery and other procedural rules. Furthermore, federal judges are perceived as being more sophisticated in understanding business transactions and as being free from favoritism for state-based industries. *See* Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991, 998-1001 & n.47 (1976).

[77]*See* cases cited note 4 *supra*. The directors find the authority to create executive committees in the articles of incorporation, by-laws, or state corporation law. Generally, a majority of the board must designate certain of its own members to the committee. The committee may, with certain exceptions, exercise all of the authority of the full board. *See, e.g.*, ABA-ALI MODEL BUS. CORP. ACT ANN. 2d § 42 (Supp. 1977).

[78]A disinterested director is a member of the board who is not "involved in a transaction with his own company where that transaction is designed to benefit that director personally . . . ." Moore, *The "Interested" Director or Officer Transaction*, 4 DEL. J. CORP. L. 674, 674 (1979). Generally, the term "disinterested director" is used to

its investigation in bad faith.[79] This novel application of the business judgment rule has been seen as the harbinger of death for the shareholder derivative suit.[80]

### B. Stock Option Plans and Self-Dealing

Although most of the independent investigation committee cases concern challenges of questionable payments made to foreign officials,[81] the cases involving self-dealing and stock option plans[82] are of particular interest in light of the traditional disposition of such scenarios.[83] The decision of the United States Court of Appeals for the Ninth Circuit in *Lewis v. Anderson*[84] provides a typical application of the business judgment rule to a litigation committee's refusal to sue. In 1973 Walt Disney Productions established a stock option incentive program for key employees.[85] In the following year the board's stock option committee granted new options to its members and to other key employees.[86] Two shareholders initiated a

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describe a director who is indifferent to the outcome of a committee's investigation into the conduct of fellow directors. *See* cases cited note 79 *infra*. *But see* Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96, 110-17 (1980) (contending that neither inside nor outside directors can be truly disinterested).

[79]*See* Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979); Abbey v. Control Data Corp., 603 F.2d 724, 729 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 275 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980); Gall v. Exxon Corp., 418 F. Supp. 508, 516 (S.D.N.Y. 1976); Falkenberg v. Baldwin, N.Y.L.J., Mar. 3, 1980, at 12, col. 6 (Sup. Ct. 1980). *But see* Maldonado v. Flynn, 413 A.2d 1251, 1263 (Del. Ch. 1980) (dictum) (defendants have burden to show good faith and independence of committee).

[80]Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96, 109 (1980). Dent referred to the litigation committee cases as "unjustifiable judicial legislation." *Id.*

[81]Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); Rosengarten v. International Tel. & Tel. Corp., 466 F. Supp. 817 (S.D.N.Y. 1979); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979); Parkoff v. General Tel. & Elecs. Corp., 425 N.Y.S.2d 599 (App. Div. 1980); Wechsler v. Exxon Corp., 55 A.D.2d 875, 390 N.Y.S.2d 111 (1977); Falkenberg v. Baldwin, N.Y.L.J., Mar. 3, 1980, at 12, col. 6 (Sup. Ct. 1980); Auerbach v. Aldrich, N.Y.L.J., Dec. 23, 1977, at 13, col. 5 (Sup. Ct. 1977); Levy v. Sterling Drugs, Inc., N.Y.L.J., Nov. 23, 1977, at 10, col. 3 (Sup. Ct. 1977).

[82]Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979); Maher v. Zapata Corp., FED. SEC. L. REP. (CCH) ¶ 97,549 (S.D. Tex. May 27, 1980); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980).

[83]*See* notes 66-70 and accompanying text *supra*.

[84]615 F.2d 778 (9th Cir. 1979) (interpreting California law).

[85]*Id.* at 780.

[86]*Id.*

derivative action claiming that the 1974 options were more favorable to the directors and, hence, violated federal securities law.[87] In response to the shareholders' challenge, the directors formed a special litigation committee composed of two outside directors and a named defendant-director who did not personally gain from the 1974 options.[88] The committee concluded that it was not in Disney's best interests to pursue the litigation, and the committee's counsel moved for a summary judgment.[89] The trial court granted counsel's motion, holding that "*if* the committee exercised its business judgment in deciding to terminate the action, that decision could not be challenged derivatively . . . ."[90]

Upholding the district court, the court of appeals in *Lewis* followed the two-step analysis previously prescribed by the United States Supreme Court in *Burks v. Lasker*.[91] The first inquiry was whether the relevant state law permitted a litigation committee to terminate a shareholder's derivative suit; the second inquiry asked whether such state law was consistent with relevant federal law.[92] To answer the first inquiry, the *Lewis* court applied a synergistic argument to find California authority permitting committees to terminate shareholder derivative suits implicating a majority of the board.[93] Although California law did not directly answer the first inquiry, the court found support for the application of the business judgment rule to the directors' good faith business decision to not pursue a cause of action.[94] The shareholders claimed that the rule did not apply when a majority of the directors were named defendants in the suit.[95]

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[87]*Id.* The directors used inside information that the Disney stock price was low and options granted at that price would be profitable. *Id.* at 783 n.2.

[88]*Id.* at 780.

[89]*Id.*

[90]*Id.* (emphasis in original).

[91]441 U.S. 471 (1979). Shareholders of an investment company alleged that the directors breached fiduciary duties under the Investment Company Act of 1940 and the Investment Advisor's Act of 1940 by purchasing $20 million in Penn Central commercial paper from its investment advisor without independently investigating the paper's quality and safety.

[92]*Id.* at 480.

[93]615 F.2d at 781-83. The *Lewis* court made its argument by citing some California cases which involved the traditional application of the business judgment rule. The court based its extension of the business judgment rule to committee decisions on the federal decisions in Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979), and Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980), neither of which construed California law. 615 F.2d at 782-83.

[94]615 F.2d at 783.

[95]*Id.* at 782.

Citing *Abbey v. Control Data Corp.*[96] and *Auerbach v. Bennett*[97] as reflecting a "clear trend in corporate law,"[98] the *Lewis* court held "that the good faith exercise of business judgment by a special litigation committee of disinterested directors is immune to attack by shareholders or the courts."[99] The decision was supported by the court's notation that the independent committee, not the defendants,[100] invoked the business judgment rule to protect its refusal to sue.[101] Furthermore, policy considerations were held to favor the decision:

> To allow one shareholder to incapacitate an entire board of directors merely by leveling changes against them gives too much leverage to dissident shareholders. There is no reason to believe that a minority shareholder is more likely to act in the best interest of the corporation than are directors who are elected by a majority of the stockholders.[102]

The *Lewis* opinion recognized that a court could probe the independence of the committee and examine its investigative procedures.[103] "The business judgment rule, as we interpret it, would not bar a derivative action when a special litigation committee of disinterested directors dismisses an action in bad faith."[104] The court skirted the independence issue by merely noting "that the independent committee members were appointed by interested directors is an 'inescapable' aspect of 'the corporation's predicament.'"[105] The *Lewis* court merely conceded that this situation "presents problems."[106]

Finding that California law authorized a committee dismissal of a shareholder's derivative suit, the *Lewis* court tersely found this interpretation of state law consistent with the policies underlying federal securities laws.[107] Thus, the second inquiry mandated by

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[96]603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

[97]47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

[98]615 F.2d at 783.

[99]*Id.*

[100]The court was apparently not concerned that one member of the committee was named as a defendant. *Id.* at 782.

[101]*Id.* at 783.

[102]*Id.*

[103]*Id.*

[104]*Id.* The court did not clearly articulate, however, who must show the committee's lack of independence or good faith. *See* note 79 and accompanying text *supra*.

[105]*Id. See also* Auerbach v. Bennett, 47 N.Y.2d 619, 633-34, 393 N.E.2d 994, 1002, 419 N.Y.S.2d 920, 928 (1979).

[106]615 F.2d at 783.

[107]*Id.* at 783-84.

*Burks v. Lasker*,[108] whether the state law is consistent with the relevant federal laws, was answered affirmatively by the *Lewis* court.[109]

## IV. The Zapata Decisions

Another stock option plan modification scenario triggered a trio of actions against the Zapata Corporation.[110] These three cases may mark the end of the "clear trend in corporate law"[111] that allows director-appointed litigation committees to terminate shareholder derivative suits under the purported auspices of the business judgment rule when a majority of the board are accused of misconduct.[112] First, the New York District Court decision[113] will be reviewed as a further extension of the *Lewis* trend. This discussion will be followed by a study of the impact on shareholders engendered by the litigation committee cases. Next, the precipitous end to the litigation committee trend portended by the subsequent resolutions of the companion Zapata actions[114] will be examined. Finally, arguments for the future application of the business judgment rule will be presented.

### *A. The Zapata Factual Background*

All three actions share the same factual background. In 1971 the Zapata board devised a stock option program under which directors and key officers could exercise options to buy Zapata common stock at $12.15 per share in five installments ending July 14, 1974.[115] Immediately prior to July 14, 1974, Zapata planned to annouce a tender offer for 2,300,000 of its own shares.[116] The announcement was predicted to raise the market price per share from $18 to about $25.[117] Realizing that significant additional federal income tax liability would be incurred by a post-announcement option exercise,[118] the

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[108]441 U.S. at 480.

[109]615 F.2d at 783-84.

[110]Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980) (decided Mar. 18, 1980). Zapata is a Delaware corporation. All three claims stem from the same misconduct, self-dealing and a stock option plan.

[111]Lewis v. Anderson, 615 F.2d 778, 783 (9th Cir. 1979).

[112]*See* cases cited note 4 *supra*.

[113]Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980).

[114]Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980).

[115]Maldonado v. Flynn, 413 A.2d 1251, 1254 (Del. Ch. 1980).

[116]*Id.*

[117]*Id.*

[118]*Id.* The capital gain incurred after the tender offer announcement would be equal to the difference between $25 per share, the market price after the announcement, and $12.15 per share, the exercise price. If the directors exercised their options

director-optionees accelerated[119] the exercise date to July 2, 1974 to avoid the capital gain consequences of a post-announcement exercise.[120] The directors exercised their options on July 2, 1974 and obtained a suspension in trading of Zapata shares until the announcement date.[121] The tender offer was made on July 8, 1974, and the market price per share immediately rose to $24.50.[122] Thus, the directors avoided personal income tax liability at the expense of Zapata's federal tax deduction for the same amount.[123]

In 1975 the shareholders filed the three actions against Zapata. Four years later, the directors created an "Independent Investigative Committee" composed of two newly appointed outside directors.[124] The committee was empowered to investigate the three claims and to dispose of them in a manner consistent with the committee's business judgment.[125] After a three month investigation, the committee determined that none of the three shareholder derivative suits were in Zapata's best interests and moved for a dismissal of all pending claims.[126] In support of its decision, the committee mustered the following twelve reasons:

> (1) the asserted claims appeared to be without merit; (2) costs of litigation, exacerbated by likelihood of indemnification; (3) wasted senior management time and talents on pursuing litigation; (4) damage to company from publicity; (5) that no material injury appeared to have been done to company; (6) impairment of current director-defendants' ability

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at the market price of $18 per share prevailing before the announcement, the capital gain would be reduced to the difference between $18 per share and the exercise price of $12.15 per share. In other words, the directors could reduce their taxable capital gain by $7 per share, a 54% reduction.

[119]*Id.* The directors moved up the date upon or after which the options could be exercised from July 14, 1974 to July 2, 1974. This ploy enabled the directors to avoid the market's reaction to Zapata's tender offer.

[120]413 A.2d at 1254. This scenario is similar to that in *Lewis* where the directors took advantage of inside information to formulate a stock opinion grant. *See* note 87 *supra.*

[121]413 A.2d at 1254-55.

[122]*Id.* at 1255.

[123]*Id.* Zapata could have offset its federal tax liability by an additional amount equal to the difference between the per share prices of $24.50 and $18.00 had the directors exercised their options on the original exercise date after the tender offer announcement.

[124]*Id.* Both of the committee members were appointed to fill vacancies in the board. The committee was formed under the corporation's bylaws and Delaware law. *See* DEL. CODE ANN. tit. 8, § 141(c) (1974) ("such committee . . . may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation . . . .").

[125]413 A.2d at 1255.

[126]*Id.*

to manage; (7) the slight possibility of recurrence of violations; (8) lack of personal benefit to current director-defendants from alleged conduct; (9) that certain alleged practices were continuing business practices, intended to be in company's best interests; (10) legal question whether the complaints stated a cause of action; (11) fear of undermining employee morale; (12) adverse effects on the company's relations with employees and suppliers and customers.[127]

### *B. The Clear Trend Continues in New York*

The first disposition of the three Zapata challenges, *Maldonado v. Flynn*,[128] was decided on January 25, 1980 by the United States District Court for the Southern District of New York. The New York derivative suit alleged that the directors' failure to disclose in election proxy materials their self-interest in the stock option plan modification violated section 14(a)[129] of the Securities and Exchange Act of 1934.[130] The shareholder sought to nullify the election of the directors stemming from the illegal proxy solicitations.[131]

In responding to the shareholder's allegations, the New York court adhered to the two step approach of *Burks v. Lasker*[132] to decide whether an investigative committee of two disinterested directors could terminate a derivative suit which named all nine fellow directors as defendants under Delaware law.[133] Noting that Delaware courts had not addressed this issue, the New York court cited the opinion of the United States Court of Appeals for the Eighth Circuit in *Abbey v. Control Data Corp.*[134] as conclusively establishing that Delaware law would apply the business judgment rule to an investigative committee's refusal to sue when a majority of the board were defendants in a suit.[135] The *Abbey* court relied on

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[127]Maldonado v. Flynn, 485 F. Supp. 274, 284 n.35 (S.D.N.Y. 1980). *See* Maher v. Zapata Corp., 490 F. Supp. 348, 350-51 (S.D. Tex. 1980).

[128]485 F. Supp. 274 (S.D.N.Y. 1980).

[129]Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n(a) (1976). Section 14(a) was promulgated to "protect investors from promiscuous solicitation of their proxies, on the one hand, by irresponsible outsiders seeking to wrest control of a corporation away from honest and conscientious corporation officials; and on the other hand, by unscrupulous corporate officials seeking to retain control of the management by concealing and distorting facts." S. REP. NO. 1455, 73d Cong., 2d Sess. 77 (1934). *See also* Orrick, *The Revised Proxy Rules of the Securities and Exchange Commission*, 11 BUS. LAW. 32 (1956).

[130]Maldonado v. Flynn, 485 F. Supp. at 278.

[131]*Id.*

[132]441 U.S. 471, 480 (1979).

[133]485 F. Supp. at 278. Eleven directors constituted Zapata's board.

[134]603 F.2d 724, 729 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

[135]485 F. Supp. at 278.

the Delaware cases of *Puma v. Marriott*[136] and *Beard v. Elster*[137] for its pronouncement. The *Maldonado* court cited *Beard* for the proposition that a court may not substitute its "uninformed opinion for that of experienced business managers of a corporation who have no personal interest in the outcome and whose sole interest is the furtherance of the corporate enterprise."[138] Relying on *Puma*, the New York court found the business judgment rule to apply "even where some board members are disqualified from participating in the board's decision . . . ."[139] Finding the power to direct litigation within the director's realm,[140] the New York court concluded:

> Thus under Delaware law a committee of disinterested directors, properly vested with the power of the board may in the exercise of their business judgment require the termination of a derivative suit brought on the corporation's behalf even though other directors are disqualified from participating in such a decision because they are named as defendants in the suit.[141]

In a footnote,[142] the court referred to the "clear trend in corporate law" recently recognized in *Lewis v. Anderson*[143] to further buttress the court's holding.

The second inquiry mandated by *Burks*[144] is whether the court's interpretation of Delaware's business judgment rule is consistent with section 14(a) of the Securities and Exchange Act of 1934.[145] Contending that the purpose of section 14(a) is to prevent management

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[136]283 A.2d 693, 695-96 (Del. Ch. 1971). The New York court also noted that section 144(a) of the Delaware General Corporation Law allows interested director transactions if approved by an informed vote of a majority of the disinterested directors. DEL. CODE ANN. tit. 8 § 144(a) (Supp. 1978).

[137]160 A.2d 731, 738-39 (Del. 1960).

[138]485 F. Supp. at 279 (quoting Beard v. Elster, 160 A.2d 731, 738-39 (Del. 1960)).

[139]485 F. Supp. at 279.

[140]*Id.* The court quoted *United Copper Sec. Co. v. Amalgamated Copper Co.*:

> Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders. Courts interfere seldom to control such discretion, *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relationship which prevents an unprejudiced exercise of judgment.

244 U.S. 261, 263-64 (1917).

[141]485 F. Supp. at 279-80.

[142]*Id.* at 280 n.16.

[143]615 F.2d 778 (9th Cir. 1979).

[144]441 U.S. at 480.

[145]Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n(a) (1976).

from obtaining authority for corporate action through deceptive proxy materials,[146] the shareholder claimed that allowing "the very violators of the statute to control exercise of this right of action renders federal law meaningless."[147] The New York court concluded that section 14(a) and the business judgment rule were consistent by citing similar rulings in *Abbey v. Control Data Corp.*[148] and *Burks v. Lasker.*[149] The *Maldonado* court also noted that although derivative suits could be terminated by the board, the business judgment rule did not totally preclude enforcement of section 14(a) claims. A shareholder could always bring an individual action or a class action on behalf of all shareholders.[150]

### *C. The Impact of the Litigation Committee Cases*

The litigation committee cases demonstrate the erosion of a shareholder's ability to derivatively protect the corporation and its shareholders from the ravages of director malversation. Allowing a board to interpose an "independent" committee's decision to not pursue the derivative action, thereby compelling dismissal of a derivative suit, leaves the shareholder uncertain of the substantive effect of the business judgment rule and of his ability to redress injuries to the corporation and its shareholders.

The most devastating impact on the shareholder results from the allocation of the burden of proof dictated by the litigation committee cases. Under the conventional application of the business judgment rule as a director's defense, the burden fell on the shareholder to impugn the rule's shield by showing fraud, self-dealing, bad faith, or lack of due care.[151] Once the shareholder made an adequate showing of impropriety or nonfulfillment of duties, the burden shifted to the director-defendant to exhibit the entire fairness of the transaction under the court's careful scrutiny.[152] Now, however, with the bastardized application of the business judgment rule, the burden falls on the shareholder to rebut the independence or good faith of the litigation committee even though a majority of

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[146]*See also* note 13 *supra.*

[147]485 F. Supp. at 281.

[148]603 F.2d 724, 731-32 (8th Cir. 1979), *cert. denied,* 444 U.S. 1017 (1980).

[149]441 U.S. at 485 (finding Investment Company Act and Investment Advisors Act consistent with state law permitting independent directors to terminate a nonfrivolous derivative suit).

[150]485 F. Supp. at 281. The court did not consider the expense and burden such alternatives would place on the shareholder. *See generally* FED. R. CIV. P. 23(c)(2).

[151]*See* text accompanying notes 30-37 *supra.*

[152]*See* text accompanying notes 55-70 *supra.*

the board are accused of wrongdoing or suffer dismissal of the derivative suit.[153]

Showing the committee's nonindependence is an onerous task[154] for the shareholder, especially when the courts find only actual participation in the tainted transaction sufficient to defeat the rule's protection of the committee's decision.[155] The New York action, *Maldonado v. Flynn*,[156] crystallizes the frustrations confronted by a shareholder challenging a committee's independence.

In *Maldonado* the shareholder attacked the committee's independence on three grounds. First, one committee member was a partner in the law firm employed by the corporation.[157] Second, one member was appointed to the board on the day the committee was formed, thereby implying that the member was appointed for the sole purpose of favorable committee membership.[158] Third, the entire committee membership was selected by the defendants.[159]

Referring to these claims as "vigorous innuendo,"[160] the court stated that "the fact that the Committee's membership became directors by appointment does not itself indicate that they bore any special loyalty to the disqualified directors or that they were any less effectively divorced from dependence upon the board then [sic] would have been the case with elected directors."[161] The opinion also noted that the committee members "owe the same fiduciary duty as any director to the corporation and its shareholders."[162]

A shareholder's frustration with attempting to reveal the committee's lack of independence is exacerbated by the common-sense awareness of the many inherent pressures on directors to be interested. An inside director's decision not to sue a fellow director

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[153]*See* cases cited note 79 *supra*.

[154]*See* Boyko v. Reserve Fund, Inc., 68 F.R.D. 692, 696 (S.D.N.Y. 1975) (excusing demand on ostensibly disinterested board because "tangible indications of bias on the part of the unaffiliated majority are rarely present"); Johnston v. Greene, 121 A.2d 919 (Del. 1956) (difficulty of showing bad faith).

[155]*See, e.g.*, Lewis v. Anderson, 615 F.2d 778, 780 (9th Cir. 1979) (court did not impugn committee's independence even though one member was a named defendant who had not gained from the transaction); Maldonado v. Flynn, 485 F. Supp. at 283 (committee found independent despite one member's partnership in law firm hired as committee's counsel).

[156]485 F. Supp. 274 (S.D.N.Y. 1980).

[157]*Id.* at 283.

[158]*Id.*

[159]*Id.* This situation was usually present in all of the litigation committee cases. Most courts only went as far as noting that this problem is inescapable. *See* Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

[160]485 F. Supp. at 284.

[161]*Id.* at 283-84.

[162]*Id.* at 283.

may be influenced by salary, promotion, fringe benefits, employee morale, and career considerations.[163] Outside directors are subject to conflicts arising from personal friendships, pressures to conform, gratitude for position, and responsibilities to other corporations.[164] By forcing the shareholder to challenge the independence of the litigation committee and by requiring more than a showing of inherent pressures in order to avoid dismissal under the business judgment rule, the courts have effectively pronounced the last rites for the shareholder's derivative suit.[165]

The litigation committee cases compound the shareholders' miseries by clouding the substantive meaning of the business judgment rule. Following the traditional use of the defense, the court in *Gottlieb v. Heyden Chemical Corp.*[166] clearly made the business judgment defense unavailable if a majority of the corporation's directors were accused of self-dealing.[167] Similarly, the United States Supreme Court in *Hawes v. Oakland*[168] gave shareholders the right to bring a derivative suit when "the board of directors, or a majority of them, are acting for their own interest, in a manner destructive of the corporation itself, or of the rights of the other shareholders."[169] Now, even though a majority of the board may be defendants, the litigation committee cases allow the committee of directors to erect the business judgment rule defense and to compel dismissal of a shareholder's derivative action.[170] Chief Judge Cooke of the New York Court of Appeals commented in his dissenting opinion to *Auerbach v. Bennett*[171] that the application of the business judgment rule to a litigation committee decision to terminate a shareholder derivative suit naming a majority of the directors placed the shareholder in a "'Catch-22'"[172] position. He also observed that the "result reached by the majority not only effectively dilutes the substantive rule of law at issue, but may also render corporate directors largely unaccountable to the shareholders whose business they are elected to govern."[173]

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[163]*See* Dent, *supra* note 80, at 111, 113.

[164]*Id.* at 111-13. *See also* Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099, 1233-34 (1977).

[165]*See* Dent, *supra* note 80, at 109.

[166]90 A.2d 660 (Del. 1952).

[167]*Id.* at 663. *See also* cases cited note 70 *supra*.

[168]104 U.S. 450 (1881).

[169]*Id.* at 460.

[170]*See* cases cited note 4 *supra*; text accompanying notes 84-143 *supra*.

[171]47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979) (dissenting opinion).

[172]*Id.* at 619, 393 N.E.2d at 1004, 419 N.Y.S.2d at 931.

[173]*Id.*

The subsequent *Zapata* decisions may mark the return of the traditional application of the business judgment rule and an end to the "clear trend in corporate law"[174] that permits a committee of disinterested directors to compel dismissal of a shareholder's derivative suit in which a corporate board has been implicated.[175]

### *D. The Clear Trend Fades in Delaware*

On March 18, 1980, nearly two months after the New York case ended,[176] the Delaware Chancery Court rendered its decision in *Maldonado v. Flynn.*[177] In state court the shareholder alleged that Zapata's directors breached their fiduciary duty to the corporation and its shareholders by depriving Zapata of a federal tax deduction in an amount equal to the reduction in capital gain achieved by the optionees who exercised their options on the accelerated exercise date.[178] The defendant-directors contended that the business judgment rule permitted a disinterested committee to compel dismissal of a derivative suit determined to be contrary to the corporation's best interests.[179] They further asserted that the burden of proof should fall on the shareholder to dispel the presumption of the committee's independence and good faith.[180]

The Delaware court denied Zapata's motion for dismissal[181] after a thorough analysis of the business judgment rule and the history of the derivative suit.[182] Beginning with a review of Delaware's application of the business judgment rule, the court's analysis revealed that

> [i]ts character as a purely defensive rule has never been seriously challenged. The rule, however, is not of universal application, nor without exception. It does not irrevocably shield all corporate transactions . . . . It requires utmost loyalty to the corporation and its interests and does not protect fraudulent, illegal, or reckless decisions by the directors . . . . And, of course, the rule has no application where there is a showing that the directors have profited at the expense of the corporation.[183]

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[174]Lewis v. Anderson, 615 F.2d at 783.

[175]*See* cases cited note 4 *supra.*

[176]Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980).

[177]413 A.2d 1251 (Del. Ch. 1980).

[178]413 A.2d at 1255.

[179]*Id.*

[180]*Id.*

[181]*Id.* at 1262.

[182]*Id.* at 1256-57, 1261-62.

[183]*Id.* at 1256 (citations omitted).

Vice Chancellor Hartnett noted that the recent federal decisions pronouncing the business judgment rule as the authority for permitting a committee of impartial directors to stop a derivative suit against a majority of the board "correctly state the business judgment rule"[184] but erroneously assume state law compels dismissal of the suit under the rule.[185] Finding the issue unaddressed by case law or statute, the court held "that under well settled Delaware law, the directors cannot compel the dismissal of a pending stockholder's derivative suit which seeks redress for an apparent breach of fiduciary duty, by merely reviewing the suit and making a business judgment that it is not in the best interests of the corporation."[186]

The Delaware court made the crucial distinction that the business judgment rule "provides a shield with which directors may oppose stockholders' attacks on the decisions made by them; but nothing in it grants any independent power to a corporate board of directors to terminate a derivative suit."[187] The Delaware court further developed the distinction by reasoning that

> [w]hile the business judgment rule may protect the Committee of Independent Directors of Zapata from personal liability if they have made a good faith decision that this suit is not in the best interests of Zapata, and should be dismissed, an analysis of the character of a derivative suit shows that the business judgment rule is irrelevant to the question of whether the Committee has the authority to compel the dismissal of this suit.[188]

The defendants claimed that the right to pursue a suit for a breach of fiduciary duty was primarily a corporate right, and a shareholder's derivative suit was subordinate to that right, notwithstanding the corporation's refusal to sue. Zapata rested its contentions upon *Hawes v. Oakland*,[189] *McKee v. Rogers*,[190] *Corbus v.*

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[184]*Id.* at 1257. The court cited *Lewis v. Anderson* and other cases for its contention. *See* text accompanying notes 84-109 *supra*.

[185]413 A.2d at 1257.

[186]*Id.* Vice Chancellor Hartnett's holding marks the first time that a Delaware court has addressed the issue of whether a committee may use the business judgment rule to compel dismissal of a shareholder's derivative suit naming a majority of the board. *See* Abbey v. Control Data Corp., 603 F.2d 724, 730 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980). *Cf.* Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980) (finding no answer in Ohio law); Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979) (finding no California law on the issue).

[187]413 A.2d at 1257.

[188]*Id.*

[189]104 U.S. 450 (1881).

[190]187 U.S. 455 (1903).

*Alaska Treadwell Gold Mining Co.*,[191] and *Ashwander v. Tennessee Valley Authority.*[192]

In distinguishing these decisisons, the Delaware tribunal stated:

> [A] stockholder may be denied the right to assert on behalf of his corporation a corporate right of action when he has failed to make a proper demand; *Hawes v. Oakland*, *supra*; if, of course, one is necessary; *McKee v. Rogers*, *supra*; or where he seeks a right not legally assertable by his corporation, *Corbus v. Alaska Treadwell Gold Mining Co.*, *supra*; or where the purportedly derivative action asserts a purely legal cause of action against an extracorporate party without any allegation that the directors have acted improperly.[193]

By relying on *Ashwander*, the court noted that Zapata "ignores the gravamen of Maldonado's suit."[194] The Vice Chancellor pointed out that Maldonado was not challenging the committee's decision to seek dismissal of the suit but was alleging a breach of fiduciary duty arising from the 1979 decision to accelerate the exercise date for the directors' personal gain at Zapata's expense.[195]

After summarizing the history of the derivative suit and finding that the corporation no longer controlled the action once it refused a shareholder's demand,[196] the court concluded:

> [A]n analysis of the business judgment rule shows that while it is a limitation on liability and ordinarily protects corporate directors when they, in good faith, decide not to pursue a remedy on behalf of the corporation, it is not an independent grant of authority to the directors to dismiss derivative suits. Under settled Delaware law the directors do not have the right to compel the dismissal of a derivative suit brought by a stockholder to rectify an apparent breach of fiduciary duty by the directors to the corporation and its stockholders after the directors have refused to institute legal proceedings, because the stockholder then possesses an independent right to redress the wrong.[197]

Commenting upon the problem of committee independence left

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[191]18 Del. Ch. 81, 156 A. 191 (1931).

[192]297 U.S. 288 (1936).

[193]413 A.2d at 1260 (citations omitted).

[194]*Id.* at 1259.

[195]*Id.*

[196]*Id.* at 1262. *See generally* Comment, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168 (1976).

[197]413 A.2d at 1262.

unresolved by *Lewis v. Anderson*,[198] Vice Chancellor Hartnett noted:

> Under our system of law, courts and not litigants should decide the merits of litigation. Aggrieved stockholders of Delaware corporations ought to be able to expect that an impartial tribunal, and not a committee appointed by the alleged wrongdoers, will decide whether a stockholder's derivative suit alleging breach of fiduciary duty has any merit.[199]

### *E. The Clear Trend Ends in Texas*

Although the Delaware version of *Maldonado v. Flynn*[200] discernibly faded the clear trend observed by the court in *Lewis v. Anderson*,[201] the United States District Court for the Southern District of Texas decision in the last of three Zapata actions may have reversed the trend completely. On May 27, 1980, *Maher v. Zapata*[202] became the first federal decision to hold that the business judgment rule did not grant directors the power to dismiss a shareholder derivative suit alleging a breach of fiduciary duty after the directors had refused the shareholder's demand.[203]

In the Texas suit, the directors were charged with violations of federal securities law[204] and with a breach of fiduciary duty under Texas corporation law.[205] As in the companion actions, the defendants claimed that the business judgment rule demanded dismissal of a derivative suit if an appointed committee of disinterested directors elected to forego a corporate cause of action alleging breach of duty.[206] The court, relying upon the Delaware Chancery Court's interpretation of Delaware corporation law in *Maldonado v. Flynn*,[207] denied the defendants' motion to dismiss.[208]

District Judge Black cut short the defendants' reliance upon the *Abbey*[209] court interpretation of Delaware law. He answered the first

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[198]615 F.2d 778 (9th Cir. 1979).

[199]413 A.2d at 1263.

[200]The Delaware court went further than any other case when it answered the first *Burks* inquiry negatively, but the end of the trend may need to await a favorable holding by the Delaware Supreme Court.

[201]615 F.2d 778 (9th Cir. 1979).

[202]490 F. Supp. 348 (S.D. Tex. 1980).

[203]*Id.* at 353.

[204]Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n (1976); Rule 14a-9, 17 C.F.R. § 240.14a-9 (1980).

[205]TEX. BUS. CORP. ACT ANN. art. 2.02A(6) (Vernon 1980).

[206]490 F. Supp. at 351. *See* cases cited notes 113 & 179 *supra*.

[207]413 A.2d 1251 (Del. Ch. 1980).

[208]490 F. Supp. at 354.

[209]603 F.2d 724, 729 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

*Burks* inquiry[210] negatively by finding that *Puma v. Marriott*[211] and *Beard v. Elster*[212] involved "the traditional application of the business judgment rule, that is, as a substantive defense on the merits of the case."[213] Quoting the Delaware *Maldonado* opinion[214] at length,[215] the Texas court stated:

> This Court is convinced, however, that the Delaware Supreme Court would adopt the reasoning of the lower court, and the rule that the business judgment rule is a purely defensive rule, and not a basis for granting a motion to dismiss a stockholder derivative suit against a corporation and its directors alleging a breach of fiduciary duty when the corporate directors, or a committee thereof, in their collective business judgment, determined that the suit was not in the best interests of the corporation.[216]

In addition the Texas court pursued the issue of the committee's independence and good faith further than the Delaware court's opinion. Finding authority to investigate the reasonableness of a committee's decision,[217] the court was "concerned whether the Committee's decision was in good faith within the bounds of reason."[218] On the issue of independence, Judge Black commented: "Plaintiffs' allegation that the Committee merely conducted a 'rationalization' of the claims instead of an investigation since the exculpation of Defendants' conduct was foreordained is not totally incomprehensible in view of the fact that the Committee was appointed by the alleged wrongdoers."[219] The court also questioned the committee's balancing of the factors influencing the committee's decision[220] and quoted: " '[T]he noninterference doctrine [the business judgment rule] should not be carried to the extreme of making an unreasonable reference of the board dispositive of the issue.' "[221]

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[210]441 U.S. at 480 (whether state law permits a committee of disinterested directors to compel dismissal of a shareholder's derivative suit implicating a majority of the board under the business judgment rule).

[211]283 A.2d 693 (Del. Ch. 1971).

[212]160 A.2d 731 (Del. 1960).

[213]490 F. Supp. at 352.

[214]Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980).

[215]490 F. Supp. at 352-53.

[216]*Id.* at 353.

[217]*Id.* (citing Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 275 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979)).

[218]490 F. Supp. at 354.

[219]*Id.*

[220]*Id.*

[221]*Id.* (quoting Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 275 n.21 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979)).

Inevitably, the proper application of the business judgment rule will be litigated again in federal courts. The Delaware and Texas decisions, however, should at least give the courts cause to rethink their interpretations of Delaware's business judgment rule. Rather than obediently following clear trends, the courts should engage in more than a cursory analysis of the business judgment rule's history, and the oppressive consequences of the rule's distortion should be forefront in the courts' "proper regard"[222] of state law.

## V. CONCLUSION

When the business judgment rule is used to defeat a shareholder's challenge to a transaction replete with conflicts of interest, the courts should consider plotting a new course for future trends in corporate law. The difficulties suffered by shareholders under the distorted application of the business judgment rule led Vice Chancellor Hartnett to express his concern:

> [I]t would seem that, under current concepts of fairness and fiduciary duty, directors who are defendants in a stockholder's derivative suit, because they approved a transaction in which they had a self-interest, and who then seek a dismissal of the suit by appointing an Independent Committee to decide whether the suit should continue, should, at least, bear the burden of showing the independence of their Committee.[223]

Even if the business judgment rule is found irrelevant to the issue whether the shareholders have an independent right to derivatively rectify a breach of fiduciary duty when the corporation refuses to sue,[224] several equities mitigate in favor of placing the burden of proof on the director-defendants. First, the corporation usually has superior access to the relevant information needed to pursue the lawsuit.[225] Second, the corporation is able to muster more resources than the shareholder. Third, procedurally, the burden should fall on the directors when self-dealing is alleged in order to retain consistency with the intrinsic fairness rule.[226] Some have even

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[222]Lewis v. Anderson, 615 F.2d at 781 (quoting Commissioner v. Estate of Bosch, 387 U.S. 456, 465 (1967)).

[223]Maldonado v. Flynn, 413 A.2d at 1263 (dictum). *See also* Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980).

[224]413 A.2d at 1255.

[225]*See* Auerbach v. Bennett, 47 N.Y.2d 619, 638, 393 N.E.2d 994, 1005, 419 N.Y.S.2d 920, 931 (1979) (dissenting opinion); C. MCCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 337, at 787 (2d ed. E. Cleary 1972); Dent, *supra* note 80, at 134.

[226]*See* text accompanying notes 55-70 *supra*.

proposed that when the majority of the board is charged with self-dealing, the unaffiliated minority should be presumed to have a conflict of interest because of the inherent, yet intangible, pressures to be dependent upon the majority.[227]

Abortion of the clear trend represented by the litigation committee cases is importuned by the resulting dilution of the business judgment rule's substantive meaning. Decisions like *Lewis v. Anderson*[228] and New York's *Maldonado v. Flynn*[229] make uncertain the breadth of the business judgment rule.[230] The New York *Maldonado* outcome is totally inconsistent with a long line of Delaware decisions which have denied the directors the protection of the business judgment defense where self-dealing was alleged.[231] As late as 1979, the Delaware Supreme Court has said that "directors . . . are bound to act out of fidelity and honesty in their roles as fiduciaries . . . . And they may not, simply because of their position, 'by way of excessive salaries and other devices [stock options], oust the minority of a fair return upon its investment.'"[232] In a shareholder's derivative suit which implicated a majority of the board, the effect of permitting a committee of directors to compel dismissal of the suit by refusing to sue under the business judgment rule is to unfairly shield self-dealing directors from the rigorous burden imposed upon them by the intrinsic fairness test. Certainly the Zapata directors would have had their hands full demonstrating to the court the entire fairness of their stock option plan modification at the expense of the corporation.

Denial of a shareholder's derivative suit implicating a majority of the board in self-dealing is also inconsistent with both federal[233] and state[234] decisions. These decisions hold that a right to sue on behalf of the corporation inures to the shareholder challenging a transaction tainted by self-dealing once the corporation refuses to sue[235] or if demand would be futile.[236] Allowing a committee appointed by the defendants to decline suit would be inconsistent with decisions like *Galef v. Alexander*[237] in which the court was "not

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[227]Dent, *supra* note 80, at 110-22.

[228]615 F.2d 778 (9th Cir. 1979).

[229]485 F. Supp. 274 (S.D.N.Y. 1980).

[230]*See* text accompanying notes 170-73 *supra*.

[231]*See* cases cited note 55 *supra*.

[232]Michelson v. Duncan, 407 A.2d 211, 217 (Del. 1979) (quoting Baker v. Cohn, 42 N.Y.S.2d 159, 166 (Sup. Ct. 1942)).

[233]*See* cases cited note 3 *supra*.

[234]Sohland v. Baker, 141 A. 277 (Del. 1927).

[235]*See* cases cited notes 3 & 234 *supra*.

[236]McKee v. Rogers, 18 Del. Ch. 81, 156 A. 191 (1931).

[237]615 F.2d 51 (2d Cir. 1980). *See* Nussbacher v. Chase Manhattan Bank, 444 F. Supp. 973 (S.D.N.Y. 1977).

aware of any case that has determined that directors against whom a claim has been asserted and who have determined that the claim against them should not be pursued, do *not* 'stand in a dual relation which prevents an unprejudiced exercise of judgment.'"[238]

By effectively denying the shareholder a remedy, the litigation committee cases place directors in a powerful position without accountability.[239] The shareholder is denied the advantages of an adversary proceeding or full discovery when a committee insulates in the business judgment rule its refusal to sue.[240] Presumably, a shareholder does not bargain for such rough treatment when he entrusts his investment to the board of directors' best business judgments.

The oppressive burden imposed upon the shareholders, the dilution of federal and state law, and the derivative suit's elegy each demand that the clear trend permitting a committee of directors to compel dismissal of a shareholder's derivative suit naming a majority of the board as defendants under the auspices of the business judgment rule must come to an abrupt end. The courts should heed the lessons taught by the Delaware disposition of *Maldonado v. Flynn*[241] and its federal companion, *Maher v. Zapata.*[242] The next clear trend in corporate law should be the return of the traditional interpretation of the business judgment rule as a defense to liability arising from mistakes in judgment. This defense should be available, however, only if the director has fulfilled all of his duties to the corporation and its shareholders.[243] Otherwise, "*Sed quis custodiet ipsos custodes*?"[244] will become an appropriate inquiry.

S. ANDREW BOWMAN

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[238]615 F.2d at 60 (referring to United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 264 (1917)).

[239]*See* text accompanying notes 171-73 *supra.*

[240]Dent, *supra* note 80, at 119-20.

[241]413 A.2d 1251 (Del. Ch. 1980).

[242]490 F. Supp. 348 (S.D. Tex. 1980).

[243]*See* text accompanying notes 10-22 *supra.*

[244]"But who is to guard the guards themselves?" VI JUVENAL, SATIRES, 1.347. *But see* Gall v. Exxon Corp., 418 F. Supp. 508, 519 (S.D.N.Y. 1976) (forbidding this inquiry).

# Markets, Time, and Damages: Some Unsolved Problems in the Field of Crops

## I. INTRODUCTION

There is a natural tendency to assume that few areas of the law must be as exhaustively settled as that of the common law of recovery in damages for injuries to agricultural crops. This inclination, however, should be resisted. The area features diverse and inconsistent approaches by the courts to recurring problems of loss measurement and remedy. Lacunae in the case law remain. This Note attempts to analyze this state of affairs and identify the most even handed, efficient, and workable remedies.

Indiana law in this area has developed in a logical, incremental manner. It now occupies a leading position nationally in the fashioning of appropriate remedies. This Note first examines its historical development. The Note then broadens its focus to discuss critically the contrasting rules, measures, and formulae for recovery established over time in the various jurisdictions.

Particular emphasis will be placed on the following concerns: First, the determination of proper damage awards for destruction of annual crops; second, the selection of the proper market or contractual value of destroyed crops; third, the determination of damages for injuries to annual crops; fourth, the effect of later contingencies such as bad weather on damages awards; and fifth, the proper role of comparison crops in determining damages. Finally, the Note considers the availability or unavailability of prejudgment interest as an element of damages awards. The Note concludes with a review of the implications of the foregoing for Indiana law.[1]

## II. OVERVIEW OF THE DEVELOPMENT OF INDIANA LAW

Viewed in the perspective of their historical development, the Indiana cases manifest a liberalizing trend in the allowable scope of a plaintiff's recovery. At least in part, however, the trend amounts

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[1]To avoid distracting complications and to reduce the scope of the discussion to manageable proportions, the following assumptions have been adopted: First, the Note assumes no possibility of reasonably cost-effective restorative treatment of injured crops. Second, only annual, as opposed to perennial, crops will be discussed. Third, no causal complications at the time of defendant's alleged tortious act are considered. Fourth, there is assumed to be no costly or compensable effort by any plaintiff to ward off or minimize injury to his crops in anticipation of the impending threat posed by the defendant's activities. Finally, except where specified, this Note assumes no waste-crop disposal costs to any plaintiff that would not otherwise have been incurred.

to a process of making explicit that which was left implicit in previous decisions.

The early Indiana case of *Avan v. Frey*,[2] though not on its facts within the scope of this Note, is of some interest. This case involved the breach by the defendant of a two-year land rental agreement. Apparently no crops were even begun by the plaintiff. The court approved a recovery by the plaintiff based on the amount and value of the crops which could have been raised on the land in each of the two years.[3]

*Avan* left several problems unresolved: Must the plaintiff have had some intention of actually raising crops on the tract in question? Must he have had the ability to raise crops of the value in question? If intention or ability is necessary for recovery, but is absent in a given case, can the plaintiff recover based on a showing of his intention to assign or sublet the land to another person for crop growing purposes? What would be the effect, if any, of a general crop failure in the relevant growing season of the second year of the breached rental agreement? Assuming that the plaintiff brings suit immediately upon the breach, what is the best way to adjust the plaintiff's recovery for the contingency of crop failure?

In *Avan*, "laying grounds for damages"[4] was merely preparatory to the plaintiff's recovery based on some particular damages formula or measure of recovery. As it was apparently not an issue on appeal, the court did not discuss the plaintiff's actual damages formula. What was added or subtracted from the crop-producing value of the land for the two-year term of the lease was simply not indicated.

The early Indiana cases that specifically involve tortious destruction of growing crops also tended to raise more issues than they resolved. The case of *Young v. Gentis*,[5] for example, involved the defendant's diversion of water into a public ditch which caused an overflow of water onto the plaintiff's land. The court found that insofar as the submersion caused permanent damage to the plaintiff's land, the measure of damages was the difference in the value of the land before and after the trespass.[6] In addition, the plaintiff was permitted to recover for crop destruction in the measure of "the value of the crop destroyed."[7]

This simple formula raises numerous problems. The court in *Young* did not discuss such crucial issues as proper time of valua-

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[2]69 Ind. 91 (1879).

[3]*Id.* at 93.

[4]*Id.*

[5]7 Ind. App. 199, 32 N.E. 796 (1892).

[6]*Id.* at 207, 32 N.E. at 798.

[7]*Id.*

tion, determination of a market price, risk of subsequent crop loss due to natural causes, and the proper role of costs and expenses not incurred by the plaintiff in growing the crop because of its tortious destruction.

Two years after *Young*, some light was shed on these issues in *Chicago & Erie Railroad v. Barnes*.[8] In *Barnes*, a distinction was drawn between crops "considerably advanced toward maturity" and those not.[9] Here, the plaintiff's growing crops were flooded due to the defendant's negligence in constructing and maintaining a bridge and culvert. The major contribution of this case lies in its general suggestion that

> [t]he value of a particular crop depends not upon its cost of production, but upon its present condition and prospects. There may be, and doubtless are, instances where the cost of production might throw light upon the value of the article, but we do not regard this as such a one.[10]

The emphasis of *Barnes* in measuring damages was thus on the present and future. The crucial unresolved issue was how to relate present and future in determining damages.

A year later, in *Louisville, New Albany and Chicago Railway v. Sparks*,[11] the elements present in the *Barnes* and *Young* opinions were brought together. The defendant,[12] a railroad, was accused of negligent reconstruction of a culvert which caused water to overflow and stand upon the plaintiff's cropland. The court found that "[w]here the destruction or injury of the crops enters into the damages as an element, such damages are measured by proof of the value of the crops with and without the injury . . . ."[13] Although the plaintiff also alleged and recovered for permanent injuries to real estate, the context seemed to indicate that the court intended the following discussion to apply to destroyed or damaged crops as well:

> Values, as counsel correctly contend, may be proved by the opinions of the witnesses, for these are, after all, but estimates based upon the fact that other property of a similar character in the neighborhood has been or could be sold for similar prices. Such opinions may also be based upon

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[8]10 Ind. App. 460, 38 N.E. 428 (1894).

[9]*Id.* at 463, 38 N.E. at 429. Damages measures in the latter category will tend to be more conjectural.

[10]*Id.*

[11]12 Ind. App. 410, 40 N.E. 546 (1895).

[12]It may be noted that historically, a remarkably high percentage of the defendants in crop damage cases were railroads. The most historically common cause of tortious crop injury apparently has been flooding.

[13]12 Ind. App. at 412, 40 N.E. at 547.

> the knowledge of the witness of persons desiring to purchase the property and the price that they are offering for it.[14]

While *Sparks* thus cast a certain glow into the darkness of uncertain recovery in this area, its light was fleeting. Suppose that a plaintiff's crops are destroyed in an immature state. Is the plaintiff then faced with the task of producing evidence of what similar ankle-high crops have sold for in that neighborhood in the past? If so, he is likely to be denied recovery. How is he to show what such immature crops could be sold for, if there is historically no market for such a commodity, except perhaps as feed?

Other questions present themselves. Could the value of a destroyed crop ever be less than zero? What if the cost of disposing of the crop outweighs the cost of marketing saved for the plaintiff? Most crucially, the court in *Sparks* called for ascertaining the value of the crop at two different times: before and after the injury. How far apart may these times properly be? Are we to consider the crop's value at the moment before the injury, and subtract the crop's value in the precise moment after the injury? If the crops are damaged, but still marketable, is there any flexibility in the matter of fixing the time of postinjury valuation? May either the plaintiff or the defendant offer evidence of post injury value based on harvest-time value? What if the plaintiff was in the habit of storing his crops for a time, and then selling them? What if the plaintiff just happened to do so on the occasion in question? What if crop storage for later sale is a widely-practiced custom in the area? A fair recovery for many plaintiffs requires considering crop prices that were obtainable months after harvest time.

Some specificity was lent to the rules for recovery in *Ayers v. Hobbs*.[15] *Ayers* involved an alleged willful and unlawful conversion by the defendant of one-half of twenty-four acres of matured but unharvested wheat. The case was decided with no special regard for the character of the converted goods as crops but rather on the general basis of conversion of personal property. It was on this theory, and without much reflection on the particular problem of damaged or destroyed crops, that the court ruled that "the measure of damages was the value of the property at the time it was converted to the appellant's use . . . ."[16]

The court in *Ayers* thus did not discuss which factors could properly be considered in determining the value of a crop, assuming that the crop was to be valued as of the time of conversion, or

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[14]*Id.* at 412-13, 40 N.E. at 547.

[15]41 Ind. App. 576, 84 N.E. 554 (1908).

[16]*Id.* at 580, 84 N.E. at 555.

destruction, or injury. Most of the problems raised by *Sparks* remained. As well, the observations of the court in *Barnes*[17] remain apposite: To what extent is evidence of the value a commodity will or would have had on a particular date in the future, relevant to its value before that date? The relevance of maturity or post-maturity value of a crop to the value of that crop in an immature state is clear. Growing crops are not typically sold for pennies an acre, though at the time of sale they are nearly worthless. Yet, determining what a destroyed crop might have fetched months later depends on unpredictable variables, if not sheer speculation.

Even if the hypothetical subsequent market or other value of a previously destroyed crop could be established with certainty, the plaintiff's damages would still not be unequivocally clear. Suppose, for example, that the defendant negligently destroyed the plaintiff's lottery ticket. Assume that but for the defendant's destructive act, the ticket would with perfect certainty have remained intact and in the plaintiff's possession. The number on the plaintiff's nonexistent lottery ticket is chosen on the day of the drawing for a huge prize. The plaintiff cannot collect, and sues the defendant. Are the plaintiff's actual damages reflected most accurately by the huge prize he has lost? Would the plaintiff be fully compensated by an award of what he paid, or slightly less than what he paid, for his ticket; perhaps by an equal price ticket with the same chance of winning as his original ticket in another unconducted lottery? Courts have treated the analogous crop damages problem in various ways.[18] The better remedies have been those that would focus more on the prize lost by the plaintiff in the original lottery.

These early Indiana cases[19] were recently utilized to establish a more explicitly liberal measure of recovery in *Richardson v. Scroggham*.[20] *Richardson*, like *Ayers v. Hobbs*,[21] involved the unlawful conversion of crops by the defendant. The court in *Richardson* distinguished *Ayers* and its time-of-the-conversion valuation. The crops in *Ayers* had been mature at the time of conversion. Recovery based on their value at that time thus fully compensated the plaintiff.[22]

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[17]10 Ind. App. at 463, 38 N.E. at 429.

[18]The reader who is anxious to discover what the value of a crop really is will recognize that the value of any particular crop, at any particular time, is equal to the value to some particular person of the right or rights to do or attempt to do one or more things, with respect to the crop, at some particular time or times.

[19]Indiana law in this area developed under collective rather than individual aegis; no single judge authored more than one of the early decisions considered here.

[20]159 Ind. App. 400, 307 N.E.2d 80 (1974).

[21]41 Ind. App. 576, 84 N.E. 554 (1908).

[22]159 Ind. App. at 405-06, 307 N.E.2d at 84.

The court went on to adopt a rule enunciated in an Illinois appellate court[23] allowing recovery based not on the negligible immediate use value of the crops at the time of their conversion, but on the value of the immature crops together with the value of the owner's rights to mature and harvest the crops at the proper time.[24]

The court in *Richardson* noted that the *Barnes* forward-looking valuation of a growing crop seemed to be predicated upon the assumption of a crop "considerably advanced toward maturity,"[25] unlike that in *Richardson.* The applicability of *Barnes* arises due to the availability in *Richardson* of photographic and close comparative evidence of yields from similar crop fields in the neighborhood also grown by the plaintiff that reduced the uncertainty of his proper measure of recovery to a level similar to that of *Barnes.*[26] The *Richardson* court also cited the rather cryptic opinion in *Avan v. Frey,*[27] to the effect that "evidence was admissible to prove the amount and value of crops which would have been raised on land as a basis for laying the groundwork for damages."[28]

Perhaps the most fundamental question raised by *Richardson* concerns what, precisely, was meant by the suggestion that the value of a growing crop "includes" its value at a later time at which it would have been harvested. Even if a harvest value reflecting "all the material facts which would affect it"[29] could be calculated, and even if proper scope for intuition and approximation were allowed,

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[23]Johnson v. Sleaford, 39 Ill. App. 2d 228, 188 N.E.2d 230 (1963). This case involved crop damage due to the defendant's cattle running at large. The court held that evidence of probable crop yields and probable market value at maturity of damaged crops should be admitted along with evidence of "the usual market value of the product at the usual market, at the harvesting season . . . ." *Id.* at 237, 188 N.E.2d at 234, 235. This rule of recovery has lost its avant-garde status, and is not as flexible and expansive in its provision for damages as the most recently enunciated Indiana rule. This new Indiana rule is discussed immediately below in connection with Decatur County AG-Servs., Inc. v. Young, 401 N.E.2d 731 (Ind. Ct. App. 1980). If the recovery can be held within speculative bounds, the plaintiff should not in all cases be confined to recovery based on "usual market value" (if such exists), and "at the usual market, at the harvesting season." Johnson v. Sleaford, 39 Ill. App. 2d at 237, 188 N.E.2d at 234. It is the particular plaintiff, and not the usual or average plaintiff, whose losses the court seeks to make whole. An individual plaintiff's recovery should reflect his own individual marketing decision and skills. The plaintiff may have intended, as a matter of habit or otherwise, to store this particular damaged crop for sale some months after the harvesting season. The threat of a plaintiff manipulating his damages is controllable by the court.

[24]159 Ind. App. at 407, 307 N.E.2d at 84-85.

[25]10 Ind. App. at 463, 38 N.E. at 429.

[26]159 Ind. App. at 405-06, 307 N.E.2d at 84.

[27]69 Ind. 91 (1879).

[28]159 Ind. App. at 406, 307 N.E.2d at 84.

[29]*Id.* at 407, 307 N.E.2d at 85 (quoting Johnson v. Sleaford, 39 Ill. App. 2d at 238, 188 N.E.2d at 235).

certain problems calling for uniform treatment would remain. Probability or improbability of maturation is an example of such an item. Suppose that a jury estimated that the likelihood of a destroyed crop's full maturation but for the defendant's tortious injury was 90%. What effect should this belief have on the plaintiff's recovery? Should the court or the jury simply assume that a 90% chance means that the crop's full maturation was otherwise "probable" and award damages based upon the full assumed harvest-time value? Or should the plaintiff's recovery be discounted somewhat to reflect the estimated 10% risk of crop loss due to natural or other nontortious causes? If no such discount is made, the plaintiff is in effect receiving an award including free crop insurance. On the other hand, if the plaintiff had purchased crop insurance, he would have been able to recover for any subsequent loss due to natural causes from his insurer, but for the defendant's tortious act. Such a plaintiff should be permitted to avoid the discounting by offering evidence at trial concerning the scope of his insurance coverage.

The most recent Indiana decision in this series is *Decatur County AG-Services, Inc. v. Young.*[30] While *Richardson* was a crop conversion case which drew support from crop injury cases, *Decatur* was a crop injury case which drew support from crop conversion cases.[31] Here, the plaintiff, Young, contracted with the defendant, Decatur, to aerially spray Young's eighteen acre soybean field with insecticide to exterminate grasshoppers.[32] The court in *Decatur* split over the relevance of the plaintiff's "usual procedure" of storing his harvested soybeans in his own storage bins for sale "after the planting period the following year."[33]

The majority held that the plaintiff's recovery need not be limited by formulae based on the injured crop's harvest-time value. The liberalizing reform of the *Richardson* crop conversion case was thus found insufficiently liberal under the circumstances in *Decatur* six years later.[34] The majority recognized that the *Sparks*[35] damages measure, which focused on the value of the crops before and after the injury, did not specify a proper time for postinjury valuation.[36]

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[30]401 N.E.2d 731 (Ind. Ct. App. 1980). Like *Richardson*, this case was decided on appeal by the First District Court of Appeals of Indiana.

[31]Johnson v. Sleaford, 39 Ill. App. 2d 228, 188 N.E.2d 230 (1963) involved crop damages due to defendant's cattle running at large. The dissent in *Decatur* discussed the crop conversion case of Lamoreaux v. Randall, 53 N.D. 697, 208 N.W. 104 (1926) and focused in particular on a wheat crop condemnation case, United States v. 576.734 Acres of Land, 143 F.2d 408 (3d Cir.), *cert. denied*, 323 U.S. 716 (1944).

[32]401 N.E.2d at 732.

[33]*Id.* at 732-33. The plaintiff offered ample evidence of his customary practice.

[34]*Id.* at 733-34.

[35]12 Ind. App. at 412, 40 N.E. at 547.

[36]401 N.E.2d at 733.

In the interests of full compensation of the injured party for the actual loss inflicted, the majority permitted damages based on the higher prices actually received by the plaintiff after storing his crops for months, rather than confining his damages to those based on the range of market prices available when his soybeans were harvested.[37] In contrast, the dissent maintained that the majority's approach was not "consistent with the general rule concerning measure of damages in the case of injury to growing crops."[38] It urged that "Young's damages should have been computed on the basis of the highest market price obtainable at the time of harvest."[39]

It will be confirmed immediately below that nationally, the cases are indeed in fractious conflict on this and other crop damage recovery issues. There is also an initially unnerving absence of explicit support for the new Indiana view allowing recovery based on postharvest prices or sales. Among the unresolved questions is this: Does it matter, as the majority in *Decatur* suggests,[40] that the plaintiff provided his own storage facilities, as opposed to paying a third party for storage? Surely it does not. The plaintiff's recovery should be reduced only if the defendant's tortious act reduced the plaintiff's storage costs below what they otherwise would have been. Further, there is no compelling reason not to extend the *Decatur* approach to cases in which the crops are completely destroyed. The plaintiff in a case of total destruction should be permitted to show what his destroyed crops would have been worth had they been matured, harvested, stored, and later marketed.

With regard to crops which are injured but nonetheless marketed postharvest, both the majority and the dissent expressed some concern over the problem of a plaintiff taking advantage of the *Decatur* rule by speculating in order to enhance his damages.[41] This concern may be based partially on the prospect of a plaintiff who testifies that his poststorage sale reflected neither the industry-wide custom, nor his own "usual procedure," as in *Decatur*,[42] but an unplanned marketing decision on his part.

Such concern for not encouraging a plaintiff to enhance or fail to mitigate his damages is overdrawn. As long as the plaintiff is not to be offered some minimum level of damages based on harvest-time crop value, his damages-based incentives still generally orient him toward rationally choosing his optimal market-based strategy. The

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[37] *Id.*

[38] *Id.* at 734 (dissenting opinion).

[39] *Id.* at 735.

[40] *Id.* at 734 (majority opinion).

[41] *Id.* at 734-35.

[42] *Id.* at 733.

defendant has, through his actions, inevitably tied himself to the plaintiff's marketing strategy and market outcome. There should rarely be evidence that this intertwining of fates has affected the plaintiff's risk-taking behavior in marketing his crops or holding them off the market. The most likely effect would be a reduced willingness on the part of the plaintiff to hold his crops off the market, paying storage costs, in hopes of securing a better price, in view of his diminished yield and prospective crop income.

Having traced the development of Indiana law, it is useful to turn now to a broader consideration of rules drawn from other jurisdictions. On the basis of a comparison of alternatives, ideal rules can be identified and workable rules developed that are applicable to Indiana and other jurisdictions.

## III. Damages Awarded for Destruction of Annual Crops

Historically, the courts have offered a variety of measures of recovery for the destruction of annual crops.[43] Much of the variety does not involve inconsistency of approach. Surely the most fundamental reason for such diversity is the ease or difficulty in a particular case of proof of damages for crops destroyed or damaged at various stages of development. Incompatibilities among the measures, however, remain significant. For ease of comparison, some of the most important formulations based on land rental value are as follows:

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[43]The aim of the court in crop destruction as well as crop damage cases has been formulated in familiar ways. These include: fair compensation for the plaintiff for the actual loss in value, perhaps with natural and proximate cause limitations, Little Rock & F.S. Ry. v. Wallis, 82 Ark. 447, 102 S.W. 390 (1907) and Staub v. Muller, 7 Cal. 2d 221, 60 P.2d 283 (1936); compensation of the plaintiff for the actual loss sustained, Chew v. Lucas, 15 Ind. App. 595, 43 N.E. 235 (1896); and placing the injured party in the position he would have occupied had the damage not occurred, Eichenberger v. Wilhelm, 244 N.W.2d 691 (N.D. 1976).

These formulations suggest that a fair damages award would leave the plaintiff indifferent between two choices: either the value flowing to him from the time of the defendant's tort, with the addition of a sum of money in damages, or the value that would have flowed to the plaintiff from the time of the defendant's tort if such tort had not occurred.

More workable methods of determining damage awards have familiar difficulties, such as proper accommodation for purely mental suffering, the payment of attorneys' fees, anxiety caused by the litigation itself, or spite and sympathy. Of greater interest with specific regard to crop damage cases are the following problems: First, are the particular qualities of the individual plaintiff given proper scope? The prices that the plaintiff might have received, but for the defendant's tort, reflect subjective factors such as his relative bargaining power and trading skills. W. Tomek, Agricultural Product Prices 219 (1972). Second, a plaintiff who has been denied an opportunity to cultivate, mature, and market a destroyed crop has been denied an opportunity to gain

A. the value of the crops destroyed is equal to the land's value immediately before the injury minus the land's value immediately after the injury;[44]
B. recovery of the diminution in the rental value of the land if the value of the crop destroyed is not practically demonstrable;[45]
C. recovery of the rental value of the land if there is no establishable market value of the crop destroyed;[46]
D. recovery of the rental value of the land plus the cost of seeding, labor, and other expenses of production if there is no establishable market value of the crop destroyed;[47]
E. recovery of the rental value of the land plus the cost of labor and materials expended plus interest if it is "unmatured" crops which are destroyed.[48]

Recoveries A through E, which are based on land rental value, share certain problems. Determining the value, or reduction in value, of farmland is made difficult by the fact that "there is no such thing as an organized farm real estate market—nationally, regionally, or

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valuable practical experience, experience worth a certain monetary value. Third, assuming that the plaintiff does not plant a further crop in mitigation of damages, there is a certain value—positive or negative—to be attached to the plaintiff's increased leisure. Prejudgment interest can be viewed as a way of minimizing a plaintiff's undercompensation, but no case attempts to come to terms explicitly with any of the three compensation problems above.

[44]Ward v. Chicago, M. & St. P. Ry., 61 Minn. 449, 63 N.W. 1104 (1895). This case involved injury to perennial crops, but the court specifically included annual crops within the rule.

[45]Harvey v. Mason City & Ft. D.R.R., 129 Iowa 465, 105 N.W. 958 (1906); Drake v. Chicago, R.I. & P.R.R., 63 Iowa 302, 19 N.W. 215 (1884); Larson v. Lammers, 81 Minn. 239, 83 N.W. 981 (1900).

[46]Faires v. Dupree, 210 Ark. 797, 197 S.W.2d 735 (1946); Brown v. Arkebauer, 182 Ark. 354, 31 S.W.2d 530 (1930); St. Louis, I.M. & S. Ry. v. Saunders, 85 Ark. 111, 107 S.W. 194 (1908). The emphasis, which seems proper, on *diminution* in rental value in these cases brings into focus the appropriateness of the plaintiff's mitigation of damages by planting a second crop or renting his land for another purpose for the term, generally a growing season or year, for which the plaintiff's land has been affected by the defendant's tort.

[47]Enright v. Toledo, P. & W. Ry., 158 Ill. App. 323 (1910); Farley v. City of Des Moines, 199 Iowa 974, 203 N.W. 287 (1925) (alternate remedies also available); Horres v. Berkely Chem. Co., 57 S.C. 189, 35 S.E. 500 (1900). Recovery of irretrievable expenditures, with interest on those expenditures, may be warranted if their value is not already reflected in an assessment of the rental value of the tract before the defendant's injury. There is a problem of excessive recovery, however, if the plaintiff's crop was destined to be a losing one due to the plaintiff's inefficiency in labor and materials costs. Perhaps it is simplest and best if, at a maximum, "ordinary" or "average" expenses are recoverable.

[48]Horres v. Berkely Chem. Co., 57 S.C. 189, 35 S.E. 500 (1900). For an only partially successful critique of *Horres*, *see* Teller v. Bay & River Dredging Co., 151 Cal. 209, 90 P. 942 (1907).

locally."[49] Idiosyncratic values often enter into farm real estate transactions[50] because some buyers or potential buyers may unwittingly offer a higher price than necessary and thereby establish an unrealistic price.[51] On the other hand, a potential seller "may want to stay in a location familiar to him, even though others want it for a more intensive use; and he sometimes wants to stay there regardless of the cost in terms of a foregone alternative opportunity."[52]

The courts must therefore consider whether testimony as to rental value is genuinely reflective of the evaluation of well-informed, prudent, impartial, unpressured lessors and lessees of the property in question. There is also a potential problem of circularity insofar as witnesses evaluate a rental property on the basis of the value of crops that might be produced on it, while the courts may have turned to the rental value measure precisely because of the speculativeness of recoveries based on crop value.

A more bothersome problem concerns whether to limit the range of possible uses upon which the rental value of the land may be based. The rental value of a tract may, for example, be higher as a parking lot or as a field for growing some crop disfavored by the plaintiff than as a wheat field. To base a plaintiff's damages on more lucrative land use options rejected by the plaintiff tends to overcompensate him.

Such problems are avoided by the following crop-value-based remedies:

F. the value of the unmatured crop at the time of the invasion, and not a presumed later market value;[53]

G. the value of the unmatured crop at the time of the invasion, and not the difference in value of the land before and after destruction of the crop;[54]

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[49]R. SUTER, THE APPRAISAL OF FARM REAL ESTATE 56 (1974).

[50]*Id.*

[51]*Id.* at 57.

[52]*Id.* at 58.

[53]Taylor v. Canton Township, 30 Pa. Super. 305 (1906); Lampley v. Atlantic Coast Line R.R., 63 S.C. 462, 41 S.E. 517 (1902); Sabine & E.T.R.R. v. Joachimi, 58 Tex. 456 (1883). This line of cases finds the presumed later market value to be speculative and irrelevant. It is of special interest that the court in *Lampley* offered in addition a presumably alternative recovery allowing rental value of the land, cost of fertilizers used, cost of labor in preparing the land, cost of cultivation up to the time of injury, the fair value of the owner's services in overseeing such work, and interest on the amount lost up until the verdict. Colorado Consol. Land & Water Co. v. Hartman, 5 Colo. App. 150, 38 P. 62 (1894) offers roughly the two remedies available in *Lampley*, as well as a recovery based on the average yield and market value of similar crops planted and cared for in the same manner, less the cost of maturing, harvesting, and marketing. *Id.* at 152, 38 P. at 63.

[54]Alabama Great S. Ry. v. Russell, 254 Ala. 701, 48 So. 2d 239 (1949); Brous v. Wabash R.R., 160 Iowa 701, 142 N.W. 416 (1913); Pascal v. Chicago, R.I. & P. Ry., 160

H. the value of the crop at the time of destruction, but no recovery if there is evidence only of the value of a matured crop;[55]

I. recovery of the market value of the crops at the time of their destruction minus later unincurred costs saved by the plaintiff;[56]

J. recovery of the value of the unmatured crops at the time of their destruction, and not merely their value for immediate severance and use;[57]

K. recovery of the value of the unmatured crop at the time of the invasion, assuming "ordinary" costs are incurred and "ordinary" care is used by the plaintiff.[58]

Recoveries based on formulae F through K above share the problem suggested by the view that there simply is no organized market for growing crops.[59] Formulae based on the value of the injured crop at the time of its destruction either undercompensate the plaintiff by failing to view growing crops as a developing investment, or solve the problem by moving in the direction of remedies L and M as follows:

L. recovery of the value of the yield but for the injury, minus the value of the amount actually produced, minus the extent of later unincurred costs saved by the plaintiff;[60]

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Iowa 484, 141 N.W. 920 (1913). The court in *Brous* offered an alternative remedy of the crop's presumed value in matured condition minus expenses for maturing and marketing. There is no discussion of the also unincurred risk of later crop failure, and the plaintiff's recovery is not discounted to reflect this factor.

[55]Thompson v. Chicago, B. & Q.R.R., 84 Neb. 482, 121 N.W. 447 (1909).

[56]Wolfsen v. Hathaway, 32 Cal. 2d 632, 198 P.2d 1 (1948). Because a major part of the difference in value between a growing and a matured crop tends to be a reflection of the value added through the plaintiff's later expenditures on his maturing crop, this remedy will tend to be inadequate. It effectively deducts the unincurred costs twice from the plaintiff's recovery, and provides very little incentive not to tortiously destroy young crops.

[57]St. Louis Merchants' Bridge Terminal Ry. Ass'n v. Schultz, 226 Ill. 409, 80 N.E. 879 (1907); Chicago & R.I.R.R. v. Ward, 16 Ill. 522 (1855) (Skinner, J., concurring).

[58]Roberts v. Lehl, 27 Colo. App. 351, 149 P. 851 (1915). Contrast the rule presented in the earlier Colorado case of Colorado Consol. Land & Water Co. v. Hartman, 5 Colo. App. 150, 38 P. 62 (1894), which allowed comparison with crops cared for in the same manner as that of the plaintiff, as opposed to those cared for in an "ordinary" way.

[59]St. Louis Merchants' Bridge Terminal Ry. Ass'n v. Schultz, 226 Ill. 409, 80 N.E. 879 (1907); Economy Light & Power Co. v. Cutting, 49 Ill. App. 422 (1893); Tretter v. Chicago & Great W. Ry., 154 Iowa 280, 134 N.W. 626 (1912).

[60]Uhrhan v. Morie, 293 S.W. 483 (Mo. Ct. App. 1927); Smith v. Hicks, 14 N.M. 560, 98 P. 138 (1908); Di Bacco v. State, 53 A.D.2d 939, 385 N.Y.S.2d 214 (1976); Hall v. Brown, 102 Or. 389, 202 P. 719 (1921); International Great N.R.R. v. Reagan, 36 S.W.2d

M. recovery of the value of the yield but for the injury, minus the value of the amount actually produced, minus all expenses of the plaintiff.[61]

This solution, found in a variety of cases, is to recognize explicitly that the value of a crop at the time of destruction includes the value of the owner's right to attempt to mature, harvest, and market the crops.[62] Section VI below discusses a major systematic difference between the value of developing and fully matured crops: the reduction of risk of injury to the crop from various natural causes.

The most fundamental distinction among crop destruction remedies, then, is that of land-rental-based remedies and crop-market-based remedies. The former category has a role to play if rental value calculations can be done independently of crop value. A further requirement is that rental value calculations in a given case be done less speculatively than those involved in determining what would have been the range of probable yields and prices of a crop, had the crop not been destroyed. This requirement will tend more to be met early in the season. Overall, the goal is to provide a universal recovery formula which can be applied whether the injury is from total inability to use a field, complete crop destruction immediately after seeding, complete destruction of growing crops, or complete destruction at full maturity.

Generally, the presumption should be that crop-value-based remedies are to be preferred. They more accurately reflect the plaintiff's loss except in cases of such early crop destruction that their speculativeness exceeds the distortions inherent in formulae based on land rental value. The simplest defensible rule would be to never apply land-rental-value-based remedies, on the assumption that estimates of rental value will inevitably reflect estimates of the value of the land's crop-growing capacity anyway.

## IV. Proper Market Selection

Indiana has set the standard in the area of the selection of the proper market for purposes of determining market price in cases of

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564 (Tex. Civ. App. 1931), *aff'd*, 121 Tex. 233, 49 S.W.2d 414 (1932); City of Portsmouth v. Weiss, 145 Va. 94, 133 S.E. 781 (1926).

[61]Peppers Fruit Co. v. Charlebois, 39 Ariz. 195, 4 P.2d 905 (1931); Beville v. Allen, 28 Ariz. 397, 237 P. 184 (1925); Brace v. Pederson, 115 Wash. 523, 197 P. 625 (1921). There is no apparent reason to deduct from plaintiff's recovery reasonable costs that he has already incurred.

[62]St. Louis Merchants' Bridge Terminal Ry. Ass'n v. Schultz, 226 Ill. 409, 415-16, 80 N.E. 879, 882 (1907); Economy Light & Power Co. v. Cutting, 49 Ill. App. 422, 425 (1893). The court in *Economy Light* found the history of above-average quality, yield, and prices from crops grown on the land to be relevant and admissible in determining the value of the crops at the time of their destruction.

crop damage or destruction.[63] Nationally, among the major rules and limitations have been the following:

A. the inadmissibility of later actual market prices;[64]
B. the inadmissibility of a general custom of holding harvested crops off the next succeeding market;[65]
C. the nearest market in time as providing the best approximation of the value of the crops at the time of their destruction;[66]
D. the nearest market in location as the best approximation of the value of the crops at the place of their destruction;[67]
E. admissibility of the price at the "usual" market;[68]
F. the "prudent man" test.[69]

The crucial conflict in the area of proper market determination lies between "nearest market" rules and the more flexible rules to which Indiana is turning.[70] The nearest market rules offer relative cer-

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[63]Decatur County AG-Servs., Inc. v. Young, 401 N.E.2d 731 (Ind. Ct. App. 1980).

[64]City of Chicago v. Dickman, 105 Ill. App. 209, 212 (1902); Burnett v. Great N. Ry., 76 Minn. 461, 79 N.W. 523 (1899). The court in *Dickman* determined that the trial court could hear only what price was reasonably probable in October as it appeared at the time of destruction in June. 105 Ill. App. at 212. This has the virtue of preserving uniformity of the plaintiff's recovery regardless of how soon or late the plaintiff brings his cause to trial. It provides for ease of calculation of the extent of liability by prospectively negligent defendants. Its fatal defect is to substantially undercompensate or overcompensate the plaintiff for his actual losses in view of rapid price rises or subsequent crop failures. The court's observation that actual October prices are produced by a multitude of causes beyond the control of the parties is not less true of probable October prices as they appear in June.

[65]United States v. 576.734 Acres of Land, 143 F.2d 408 (3d Cir.), *cert. denied*, 323 U.S. 716 (1944). In this condemnation action, the United States was found obligated to pay for the value of the leasehold on the day of the taking, at which time the unmatured crop was said to have a value to be established at the "nearest" time thereafter as possible. The court did not come to terms with the view that the value of a growing crop includes the right to continue to mature it. *Id.* at 409-10.

[66]United States v. 576.734 Acres of Land, 143 F.2d 408 (3d Cir.), *cert. denied*, 323 U.S. 716 (1944); American Smelting & Refining Co. v. Riverside Dairy & Stock Farm, 236 F. 510 (8th Cir. 1916); Sayers v. Missouri Pac. Ry., 82 Kan. 123, 107 P. 641 (1910).

[67]American Smelting & Refining Co. v. Riverside Dairy & Stock Farm, 236 F. 510 (8th Cir. 1916); Tretter v. Chicago & G.W. Ry., 154 Iowa 280, 134 N.W. 626 (1912); H.F. Wilcox Oil & Gas Co. v. Murphy, 186 Okla. 188, 97 P.2d 84 (1939); Missouri, K. & T. Ry. v. Gilbert, 58 Tex. Civ. App. 467, 124 S.W. 434 (1910). It is possible that the nearest market in time and the nearest market in place to the time and place of destruction are two different markets, with different market prices.

[68]Johnson v. Sleaford, 39 Ill. App. 2d 228, 188 N.E.2d 230 (1963). The court allowed evidence of "the usual market value of the product at the usual market, at the harvesting season." *Id.* at 237, 188 N.E.2d at 234.

[69]Chicago & R.I.R.R. v. Ward, 16 Ill. 521 (1854) (Skinner, J., concurring).

[70]Decatur County AG-Servs., Inc. v. Young, 401 N.E.2d 731 (Ind. Ct. App. 1980).

tainty, simplicity, and predictability. Their important defect is their tendency to result in improper compensation for the plaintiff's actual losses. A plaintiff's choice of market and decision as to storage time can be financially crucial. In the case of wheat crops, for example, "[p]rices in the 1973-74 marketing year rose to an average of $3.95 compared with $1.76 the previous year."[71] During any one particular growing season, "[p]rices rise much more than average . . . [or they may] rise much less than average or actually decline . . . ."[72] For soybeans at the Chicago market, "prices in the 1968-1972 period were highest in July and December; however, peak prices sometimes occur during the early spring."[73]

This volatility of price swing underscores the important practical difference between "nearest market" rules and more flexible market determination rules. It also highlights the superiority of the more flexible rules because such rules take better account of delayed, postharvest sales. The only way to defend the "nearest market" rules is through the assumption that the plaintiff's increased market price for his stored crops tends to be balanced out by his increased storage costs. The jury would then be instructed not to deduct the plaintiff's unincurred storage costs from his recovery. An actual balancing in any given case, however, would be fortuitous.[74]

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[71]G. SHEPHERD, G. FUTRELL, J. STRAIN, MARKETING FARM PRODUCTS 396 (6th ed. 1975).

[72]*Id.* at 138.

[73]*Id.* at 137.

[74]Fairness to the defendant as to the extent of his liability is a consideration here. What if the plaintiff had contracted before the loss, or found a buyer after the loss, who was willing to swap a barrel of oil for a bushel of wheat? Can it be said that the defendant should reasonably have foreseen such a possibility, and hence expended more money on being careful? Surely not.

In such cases, it is relevant to ask which of the parties could have avoided or prevented the plaintiff's huge and rare loss at the lower cost. Could the plaintiff have cheaply avoided the loss by informing all the area crop-dusters, railroads, neighbors, and industrial plants of his good fortune in locating his over-eager buyer? Or could the defendant have more cheaply avoided the accident by conducting his operations in light of his telephone survey of the price prospects of area croplands? For Leon Green's approach to the problem of foreseeability of the extent of loss, see Green, *Foreseeability in Negligence Law*, 61 COLUM. L. REV. 1401, 1405-06 (1961).

This problem should be approached with some care. Splitting the liability by holding the defendant liable for only the reasonably foreseeable extent of the plaintiff's loss, though apparently fair, may tend to generate unfortunate outcomes that leave everyone worse off. If, for example, a $150 loss is split so that the plaintiff is liable for $50 and the defendant for $100, neither party will have an incentive to avoid the accident if the plaintiff could have prevented the accident by spending $60 or if the defendant could have avoided the accident at a cost to him of $110. The accident will improperly tend to occur, at a possible social cost of $150 - $60 or $90. The goal of avoiding such waste might be better served by imposing the entire liability on the party who could have avoided the accident at the lower cost, perhaps in conjunction with a last clear chance rule.

The "prudent man" test[75] focuses attention on what a prudent man would have given for the crop prior to its destruction, provided he would have it secure from trespass and have the right to further cultivate it.[76] It would logically include the right to choose the optimal market and time of marketing, thus improving upon the "nearest market" formulations.

The major drawback of the prudent man test lies in the problem of subsequent innocent crop loss. It is not easy to determine how much a reasonable and prudent person would have discounted his price due to the risk of crop loss between the time of the defendant's tortious injury and the sale of the crop or the passing of the risk of loss. The first problem is that rainfall, hail, wind, and heat occuring "during critical harvesting periods represent random variables. The number of workdays available for routine tasks such as plowing, planting, and cultivating are random variables."[77] The second and more crucial problem is that little research has been devoted to determining the frequency of these and other important random inputs.[78] It would thus be much easier to allow the plaintiff to bear the loss if it should appear that his crop would later have been damaged or destroyed innocently, regardless of the defendant's action.

## V. DAMAGES FOR MARKETABLE INJURED CROPS

In the area of damages to be awarded for injury to annual crops which are nonetheless marketed or marketable,[79] the courts have spoken with more than one voice. Some of the remedies deserving of attention include:

A. recovery of the diminution in the crop's market value immediately before and after the injury, with the value of the uninjured crop at maturity inadmissible;[80]

B. recovery of the diminution in market value immediately before and after the injury, with the market value of

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[75]*See* note 69 *supra.*

[76]Chicago & R.I.R.R. v. Ward, 16 Ill. 522, 533 (1854).

[77]J. DOLL, V. RHODES, J. WEST, ECONOMICS OF AGRICULTURAL PRODUCTION, MARKETS, AND POLICY 193 (1968).

[78]*Id.* at 201.

[79]This would include cases of stunted growth or reduced yields.

[80]Gresham v. Taylor, 51 Ala. 505 (1874); Sayers v. Missouri Pac. Ry., 82 Kan. 123, 107 P. 641 (1910); Sabine & E.T.R.R. v. Joachimi, 58 Tex. 456 (1883). This line of cases finds the maturity value to be the result of too many arbitrary contingencies to serve as a valid and reliable indicator of the value of the immature crop at the time of its injury.

the crops at maturity admissible but not in itself a component of a proper measure of damages;[81]

C. recovery of the diminution in market value immediately before and after the injury, and the market value of the crops at the time of maturity minus some or all expenses is a proper measure of damages;[82]

D. recovery of the value of the crops but for the injury minus the value actually received;[83]

E. recovery of the value of the crops but for the injury minus expenses saved for the plaintiff minus the actual value of the crop at maturity received by the plaintiff;[84]

F. recovery of the value of the prospective crop when harvested minus the prospective cost of harvesting and marketing, with a reasonable-certainty-of-maturity limitation, and with the rental value of the land recoverable in addition;[85]

G. recovery of the value of the prospective crop when harvested minus the unincurred cost of cultivation, harvesting, and marketing saved by the plaintiff, minus the value of the crop actually received by the plaintiff, plus the price paid by the plaintiff for the insecticide which failed to prevent the crop damage.[88]

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[81]Ingargiola v. Schnell, 11 So. 2d 281 (La. Ct. App. 1942); Abilene & S. Ry. v. Herman, 47 S.W.2d 915 (Tex. Civ. App. 1932). This line of cases allows evidence of maturity values of crops as indicators of the value of the crops at the time of injury.

[82]Peppers Fruit Co. v. Charlebois, 39 Ariz. 195, 4 P.2d 905 (1931); Mahaffey v. Carlson, 39 Idaho 162, 228 P. 793 (1924); Tretter v. Chicago & G.W.R.R., 154 Iowa 280, 134 N.W. 626 (1912); First Wis. Land Corp. v. Bechtel Corp., 70 Wis. 2d 455, 235 N.W.2d 288 (1975); Bader v. Mills & Baker Co., 28 Wyo. 191, 201 P. 1012 (1921). A number of opinions in this area fail to specify unequivocally that it is only the unincurred costs that plaintiff would otherwise have had to pay that are being deducted from his recovery. *See, e.g.*, Brace v. Pederson, 115 Wash. 523, 197 P. 625 (1921). There is no obvious justification for requiring the plaintiff to in effect pay twice for tilling the soil.

[83]Burt v. Lake Region Flying Serv., 78 N.D. 928, 54 N.W.2d 339 (1952). The proper role of expenses saved by the plaintiff is not discussed.

[84]Steffen v. County of Cuming, 195 Neb. 442, 238 N.W.2d 890 (1976); Swenson v. Chevron Chem. Co., 89 S.D. 497, 234 N.W.2d 38 (1975); Cutler Cranberry Co. v. Oakdale Elec. Coop., 78 Wis. 2d 222, 254 N.W.2d 234 (1977). In Cross v. Harris, 230 Or. 398, 370 P.2d 703 (1962), the court allowed recovery of the cost of destroying the damaged crops in addition to the above measure. *Id.* at 409, 370 P.2d at 709.

[85]United Verde Cooper Co. v. Ralston, 46 F.2d 1 (9th Cir. 1931). Language in this opinion requiring the deduction of the costs of "producing" the crop from the plaintiff's recovery is not to be read strictly, as this would effectively require the plaintiff to pay certain production costs twice. *Id.* at 2. The court in *Ralston* also found the rental value of the land to be recoverable. *Id.*

[88]Swenson v. Chevron Chem. Co., 89 S.D. 497, 234 N.W.2d 38 (1975). In this case, the plaintiff recovered a $717 insecticide price on the theory that the insecticide did

Once the distractions of double recovery and double payment by the plaintiff are removed,[87] it becomes clear that the major line of division is between the remedies focusing on immediate diminution in market value, as in remedies A through C above, and remedies based in part on the prospective value of the crop but for the injury, as in remedies D through G. That this division can be partially reconciled is suggested by the consideration, in Section III above, of the extent to which immediate loss in value after the injury must inevitably reflect the loss in attainable future value. On this point, the court's discussion in *First Wisconsin Land Corp. v. Bechtel Corp.*[88] is illuminating:

> The defendants' theory is that testimony as to the plaintiff's costs in growing the beans was irrelevant and should not have been considered by the jury, because the question for consideration was the difference in the value of the crop before and after the injury. In estimating the value of the crop before the injury, it was necessary to know what the crop could be expected to bring at harvest time and what the cost of growing the crop would be. The difference between these two figures is an acceptable method of estimating the value of the crop before the injury.[89]

Just as the preinjury value of the crop reflects the value of the right to attempt to further mature and market the crop, so the value of the right to attempt to further mature and market the crop reflects the further, not yet incurred costs of additional maturation, harvesting, and marketing. The simpler and less circuitous remedy would offer the plaintiff the probable value of the prospective crop, but for the defendant's injury to it, with deductions for the costs of maturing, harvesting, storage, and marketing unincurred or reduced as a result of the defendant's action and for the value of the crop actually marketed by the plaintiff.

As suggested above in Section IV, this simpler remedy should be applied in a crop storage case, not by focusing on the value of the prospective crop only at harvest time nor by considering only some customary time of marketing postharvest, but by considering any postharvest time of marketing chosen in good faith by the plaintiff.

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not perform as warranted but would have been worth the price if it had performed as warranted. The better view is that the plaintiff had already been made whole by the court's remedy and that the probable value of his crop at maturity, but for the injury, reflected the increased or more predictable yield which would have been possible by the use of an effective insecticide.

[87] *See* notes 82-86 *supra*.

[88] 70 Wis. 2d 455, 235 N.W.2d 288 (1975).

[89] *Id.* at 463, 235 N.W.2d at 292.

## VI. Postinjury Risks and Accidents

Remaining to be considered in further detail are several problems affecting the basic damages measures. First is a more explicit look at the effects of postinjury contingencies on crop yield or crop value. Among the most noteworthy approaches are these:

A. The risk of later hail, flood, or other weather hazards must be considered with respect to the plaintiff's damage award.[90]
B. An actual later destructive flood does not affect the plaintiff's damages.[91]
C. Evidence of conditions subsequent to the crop loss is inadmissible.[92]
D. An actual later destructive innocent flood does affect the plaintiff's damages.[93]

The first aim here must be to avoid rules allowing systematically excessive recoveries. One court has urged that "it would not have been proper to have admitted . . . evidence showing that a week or two after the destruction of the crop, all the crops in the neighborhood . . . were destroyed by drought . . . or a tempest, over which neither appellant, appellee nor any other person had any control."[94] This view reflects the approach to damages issues by which damages are fixed by a hypothetical transaction between the plaintiff and a market buyer immediately after the injury or destruction of the crops. On this view, fortuitous events occuring a week later are irrelevant.

Such an approach, however, results not only in making the plaintiff whole, but in providing him with full and costless crop failure and crop loss insurance from the time of the defendant's injury. There is no obvious reason to do this, as long as the plaintiff is otherwise fully compensated. The real choice is between attempting to discount all recoveries to reflect the proper risk of crop loss that

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[90]St. Louis Sw. Ry. v. Ellis, 169 Ark. 682, 276 S.W. 996 (1925); Dutra v. Cabral, 80 Cal. App. 2d 114, 181 P.2d 26 (1947); Drake v. Chicago, R.I. & P.R.R., 63 Iowa 302, 19 N.W. 215 (1884); Hopper v. Elkhorn Valley Drainage Dist., 108 Neb. 550, 188 N.W. 239 (1922). In Sayers v. Missouri Pac. Ry., 82 Kan. 123, 107 P. 641 (1910), this rule was applied even though the crop was ready for harvesting at the time of injury by the defendant.

[91]Zuidema v. Sanitary Dist., 223 Ill. App. 138 (1921); City of Chicago v. Dickman, 105 Ill. App. 209 (1902). *See also* C. McCORMICK, Handbook of the Law of Damages § 126, at 488 (1935).

[92]Burnett v. Great N. Ry., 76 Minn. 461, 79 N.W. 523 (1899); Ward v. Chicago, M. & St. P. Ry., 61 Minn. 449, 63 N.W. 1104 (1895).

[93]St. Louis, I.M. & S. Ry. v. Yarborough, 56 Ark. 612, 20 S.W. 515 (1892) (imminent flooding hastened by the defendant's actions).

[94]City of Chicago v. Dickman, 105 Ill. App. 209, 212 (1902).

the plaintiff would have had to bear, and allowing the plaintiff to bear his own losses if his crops would probably have been destroyed innocently regardless of the defendant's conduct. Subject to the plaintiff's ability to prove that his procurement of insurance coverage was rendered ineffective by the defendant's tortious conduct, this Note recommends the latter course in view of its practical simplicity. The argument for this approach is strengthened if it appears that growers can insure their own crops against such contingencies more cheaply than can potential defendants.

A second problem associated with the basic damages measures is that of the admissibility and proper role of evidence, going to the plaintiff's damages, of the productiveness of unaffected comparable fields, owned by the plaintiff himself[95] or by neighbors,[96] and of evidence of prior production years on the same land.[97] The crucial question remains that of how comparable the proffered evidence must be. The answer in ideal terms is simply this: The court should allow comparison evidence as to quality of land, type of crop, growing method, circumstances, and so on if its tendency to mislead is less important than its contribution to the case in determining the actual or prospective value of the plaintiff's crop.

More practically, it is appropriate to rely on the incentives set up by the adversary process to minimize the effect of misleading comparisons. If the plaintiff may show an apparently large loss based on his best three yields in the five previous production years, the defendant should be permitted to show not only that the plaintiff is relying on inconsistent assumptions, but that the plaintiff's best four yields in the five previous production years show a smaller loss.[98] The court should impose a limit here only when the complexity of the evidence threatens to drive the jury to return simply an intuitively based judgment.[99]

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[95]Teller v. Bay & River Dredging Co., 151 Cal. 209, 90 P. 942 (1907); Smith v. Hicks, 14 N.M. 560, 98 P. 138 (1908).

[96]The court in Hall v. Brown, 102 Or. 389, 202 P. 719 (1921), required a showing of similarity in variety of grain sown, amount sown per acre, time when sown, and method of cultivation.

[97]Johnson v. Sleaford, 39 Ill. App. 2d 228, 188 N.E.2d 230 (1963); Sayers v. Missouri Pac. Ry., 82 Kan. 123, 107 P. 641 (1910); Cutler Cranberry Co. v. Oakdale Elec. Coop., 78 Wis. 2d 222, 254 N.W.2d 234 (1977).

[98]Cutler Cranberry Co. v. Oakdale Elec. Coop., 78 Wis. 2d 222, 224-25, 254 N.W.2d 234, 236 (1977).

[99]One might reflect here on the case of Armer v. Nagels, 149 Kan. 409, 87 P.2d 574 (1939). The court here held that in arriving at the value of a destroyed barley crop, the jury might consider the quality of the land for the crop of barley, preparation of the ground, quality of the seed planted, the manner in which the crop had gone through the winter, quality of the season for similar crops in the vicinity, the barley yield on that farm and on farms in the vicinity in the past, the necessity of any further work on the crop, and the availability of a market and the market price of barley for

## VII. Prejudgment Interest

The availability or unavailability of prejudgment interest as an element of the plaintiff's damage award poses a final subsidiary problem. Within the cases there has been a lack of uniformity and often a lack of discussion of the problem. A large number of cases allow interest from the date of the injury.[100] Complications arise, however, along the following lines:

A. Interest from the date of injury is not available to the plaintiff if his damages are unliquidated.[101]
B. Interest from the date of injury is discretionary with the jury.[102]
C. Interest from the date of injury to the date of the trial is includable as an element of damages.[103]
D. Interest from the date of injury to the date of the verdict is includable as an element of damages.[104]

The offering of prejudgment interest to the plaintiff is justifiable if the plaintiff's injury is conceived of as involving the deprivation of use of valuable income-producing property. This would characterize the situation if the court concerns itself with what the crops in question would have been worth immediately before and after the time of injury, or even the reasonable rental value of the land in question. It becomes less important as the court allows remedies based on crop value at some later time, presumably closer to trial, thus affording the plaintiff fuller compensation. In any event, allowing interest up to the time of the verdict, as opposed to the time of trial, provides fuller compensation for the plaintiff in the absence of deliberate delay on the plaintiff's part.[105]

## VIII. Conclusions as to Indiana Law

From this analysis, two major conclusions appear. First, the lack of support in the cases for a postharvest crop valuation[106] is real, but

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seed. This level of detailed comprehensiveness would tend to lessen, rather than enhance, the jury's fidelity to damages law. *Id.* at 412, 87 P.2d at 576.

[100]*See, e.g.*, Little Rock & F.S. Ry. v. Wallis, 82 Ark. 447, 102 S.W. 390 (1907); St. Louis Merchants' Bridge Terminal Ry. Ass'n v. Schultz, 226 Ill. 409, 80 N.E. 879 (1907); Horres v. Berkely Chem. Co., 57 S.C. 189, 35 S.E. 500 (1900).

[101]Smith v. Platte Valley Pub. Power & Irrigation Dist., 151 Neb. 49, 36 N.W.2d 478 (1949); Calcagno v. Holcomb, 181 Or. 603, 185 P.2d 251 (1947).

[102]Midland Valley R.R. v. Snider, 161 Okla. 215, 17 P.2d 954 (1932).

[103]Trinity & S. Ry. v. Schofield, 72 Tex. 496, 10 S.W. 575 (1889).

[104]Lampley v. Atlantic Coast Line R.R., 63 S.C. 462, 41 S.E. 517 (1902); Sabine & E.T.R.R. v. Joachimi, 58 Tex. 456 (1883).

[105]*See* Walker, *Interest on Damages*, 120 New L.J. 308, 310 (1970).

[106]Decatur County AG-Servs., Inc. v. Young, 401 N.E.2d 731 (Ind. Ct. App. 1980).

is only superficial. This Note has shown that a reasonable extension of the best logic of the Indiana cases is all that is required. The court in *Decatur*, in allowing a postharvest valuation of a damaged crop, properly refused to be distracted from the goal of compensating the injured party for the loss sustained.[107]

The second point to be noted is that there is no evident reason to confine this remedy to cases of injured but later marketed crops. The equities call for allowing the owner of a destroyed crop to show the probable value of his crop had he matured it, harvested it, stored it, and then marketed it, all at his expense. To confirm a plaintiff's good faith in claiming this remedy for the destruction of a crop, he should offer evidence of his choosing storage and a later sale, rather than a harvest-time sale, at a time before the price of such stored crops became available for comparison. With this restriction, it is hoped that in an appropriate case, the courts will thus extend the logic of *Decatur*.[108]

R. GEORGE WRIGHT

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[107]*Id.* at 733.

[108]The secondary source material relevant to the themes and specific discussion topics of this Note is purveyed largely in widely scattered snippets, there being, as Robert Nordstrom observes, a remarkable paucity of scholarly treatment of damages issues. Nordstrom, *Damages as Compensation for Loss*, 5 N.C. CENT. L.J. 15, 34-35 (1973). A few sources have been cited and discussed above and will not be further mentioned here.

On the issue of foreseeability, and particularly foreseeability of the extent of the plaintiff's loss, there is a substantial body of literature from diverse perspectives. One might begin with RESTATEMENT (SECOND) OF TORTS § 435 (2) (1965) and W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 43, at 260-61 (4th ed. 1971). From the perspective of law and economics, one might look first at Calabresi, *Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr.*, 43 U. CHI. L. REV. 69, 95-98 (1975) and R. POSNER, ECONOMIC ANALYSIS OF LAW 130-31 (2d ed. 1977).

Payne, *Foresight and Remoteness of Damage in Negligence*, 25 MOD. L. REV. 1, 13 (1962) notes the general irrelevance to the defendant's liability of the circumstance that, for example, the infection entering a wound is an exceedingly rare one. Street, *Supervening Events and the Quantum of Damages*, 78 L.Q. REV. 70, 72-73 (1962) mentions the case of crop destruction. Equally interesting is its brief discussion of an English case in which the plaintiff was found not entitled to greater damages for his ship, sunk at sea, even in view of the increased value it would have had due to the outbreak of war, had it reached port. Atiyah, *Negligence and Economic Loss*, 83 L.Q. REV. 248, 263 (1967) focuses on disallowance of recovery for unforeseeable, though direct, consequences of the defendant's tort. Note, *Taking the Plaintiff As You Find Him*, 16 DRAKE L. REV. 49, 56 (1966) focuses in particular on Iowa's allowance of recovery of damages due to unforeseeable aggravation of an existing injury, to the extent of the aggravation. Linden, *Down with Foreseeability! Of Thin Skulls and Rescuers*, 47 CAN. B REV. 545, 550, 553-54 (1969) generally follows the approach indicated by its title.

A number of commentaries discuss tortious injuries to crops caused by a defendant's crop dusting or crop spraying, as occurred in Decatur County AG-Servs., Inc. v.

Young, 401 N.E.2d 731 (Ind. Ct. App. 1980). Perhaps the most thorough item, but lacking a discussion of damages issues, is Note, *Crop Dusting: Two Theories of Liability?*, 19 HASTINGS L.J. 476 (1968). Carsey, *Crop Dusting—The Evolution and Present State of the Law*, 6 FORUM 12, 12 (1970) similarly eschews damages issues, but informatively contrasts negligence, strict liability, and warranty as potential theories of a defendant's liability. Note, *Liability in Crop Dusting: A Survey*, 42 MISS. L.J. 104, 106-09 (1971) focuses on negligence and strict liability as alternative theories of recovery, and Note, *Trespass—Basis of Liability—Damage Caused by Aerial Crop Spraying*, 38 N.D.L. REV. 536 (1962) similarly contrasts negligence and ultra-hazard theory. Neither of the above, nor Comment, *Crop Dusting—Scope of Liability and a Need for Reform in the Texas Law*, 40 TEX. L. REV. 527 (1962) despite their merit, mentions damages issues or problems.

Damages for injuries to crops are the subject of implication, if not thorough discussion, in several recent articles. Note, *Survey of Tort Damages*, 14 WASHBURN L.J. 466, 467, 479, 497 (1975) raises the crop damages issues, attempts a characterization of the meaning of compensatory damages and of general and consequential damages, and discusses briefly the important case of Sayers v. Missouri Pac. Ry., 82 Kan. 123, 107 P. 641 (1910). Comment, *Measure of Damages for Injury to Real Surface Property in Wyoming*, 2 LAND AND WATER L. REV. 235, 240-43 (1967) includes a brief discussion of crop damages, focusing without much elaboration on a rule allowing the plaintiff to recover based on the crop's market value if it is mature and on loss of expected profit if it is not. Note, *Damages—Destruction of Fruit Trees—A Proper Rule of Valuation*, 14 WAYNE L. REV. 1211, 1216-17 (1968) is of interest for its discussion of recovery based on the optimal value use of the real property by the plaintiff, as opposed to recovery based on the suboptimal actual present use of the property by the plaintiff, which may better reflect the plaintiff's actual losses.

A number of items are of indirect but still substantial interest. Note, *Mitigation of Damages Through the Use of Stock Market Indicators*, 47 IND. L.J. 367, 367 (1972) discusses a case in which judicial notice was taken of the 1969 stock market decline, leading to the conclusion that such decline, and not the defendant's wrongful omission, caused the decline in value of the property in question. Cole, *Windfall and Probability: A Study of "Cause" in Negligence Law*, 52 CAL. L. REV. 764, 784-85, 812-13 (1964) discusses the probabilistic validation of contrafactual propositions such as, for example, the proposition that if a defendant had known of the unexpectedly high value of a plaintiff's crops, he would have been careful enough to avoid injuring them. Cole goes on to characterize a "windfall" as "the unearned and unexpected receipt of a measureable advantage inconsistent with the rules of distribution." *Id.* at 813. Note, *Damages Contingent Upon Chance*, 18 RUTGERS L. REV. 875, 892-94 (1964) discusses the relatively great boldness of English law in allowing recoveries to more accurately reflect specific calculations of the probability of occurrence of the event in question.

In Nordstrom, *Toward a Law of Damages*, 18 W. RES. L. REV. 86, 86 (1966), a narrower and a broader meaning of "compensatory" damages is detected, with the former meaning limited to the expectancy interest, and the latter including the plaintiff's expectancy, reliance, and restitutionary interests.

Finally, a pervasive and intractable problem is addressed in Feldman and Libling, *Inflation and the Duty to Mitigate*, 95 L.Q. REV. 270, 275, 279, 282, 286 (1979). The authors find no general duty of plaintiffs to mitigate the effects of inflation, thus offering at least partial justification for this Note's careful avoidance of the topic.

# Twenty-Five Years of Uninsured Motorist Coverage: A Silver Anniversary Cloud with a Tarnished Lining

## I. INTRODUCTION

The American system of automobile accident reparations had a bright forecast in 1898, when the first automobile liability policy was offered to the motoring public.[1] Shortly thereafter, a cloud appeared in the form of financially irresponsible drivers—motorists who were unable to monetarily recompense the damages caused by their negligent driving.[2] As the number of uncompensated accident victims increased,[3] several state legislatures, including Indiana's,[4] responded by enacting financial responsibility laws.[5] These laws generally re-

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[1]Plummer, *The Uncompensated Automobile Accident Victim*, 1956 INS. L.J. 459, 463.

[2]A. WIDISS, A GUIDE TO UNINSURED MOTORIST COVERAGE, § 1.1 (1969).

[3]*Id.*

[4]IND. CODE § 9-2-1-15 (1976). The Indiana statute is representative of the legislation enacted in most states. It provides:

> Proof of financial responsibility shall mean proof of ability to respond in damages for liability thereafter incurred, arising out of the ownership, maintenance or use of a motor vehicle, in the amount of fifteen thousand dollars ($15,000) because of bodily injury to or death of any one (1) person, and, subject to said limit respecting one (1) person, in the amount of thirty thousand dollars ($30,000) because of bodily injury to or death of two (2) or more persons in any one (1) accident, and in the amount of ten thousand dollars ($10,000) because of injury to or destruction of property in any one (1) accident. Proof in the amounts required by this section shall be furnished for each motor vehicle registered by such person.

*Id.*

[5]All fifty states have some form of financial responsibility legislation in force at the present time. There are basically two forms: (1) the "one accident" form, which requires proof of financial responsibility only *after* the owner/operator has been involved in an accident, and (2) the "one judgment" form, which requires proof of financial responsibility after the owner/operator has had a judicial or administrative judgment of fault rendered against him. For a comprehensive evaluation of state legislative steps treating the financially irresponsible motorist, *see* Comment, *The Financially Irresponsible Motorist: A Survey of State Legislation*, 10 VILL. L. REV. 545 (1965) [hereinafter cited as Comment].

Indiana's statute is essentially the "one accident" form. *See* IND. CODE § 9-2-1-4 (Supp. 1980). However, it should be emphasized that this is only a *general* classification. The financial responsiblity statutes of each state may vary significantly as to their administration and enforcement mechanisms. For example, in Indiana the Commissioner of the Bureau of Motor Vehicles is given considerable discretion as to who must file proof of financial responsibility after an accident. Administrative regulations provide:

> (a) Upon receipt of an accident report in which no proof of financial responsibility is indicated for either or both of the parties involved in the

quired that each person registering an automobile in the state demonstrate his ability to answer financially, up to the statutory limits,[6] for any bodily injury or property damage liability incurred through the "ownership, maintenance or use of a motor vehicle."[7]

The financial responsibility laws failed to remedy the uninsured motorist problem, principally because they were not "triggered" for enforcement until the owner was involved in at least one accident.[8] A few insurance companies, motivated by the demand for a better solution to the uninsured motorist dilemma and the increasing probability of governmental intervention, offered "unsatisfied judgment" endorsements as a supplement to their automobile liability policies.[9]

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accident, the Bureau of Motor Vehicles shall notify the party or parties that they must provide proof of financial responsibility.

(b) The individual(s) shall be informed that they may provide proof of financial responsibility by any of the foregoing methods (proof of insurance, bond, release) or that they may request a fault hearing.

(c) The fault hearing conducted by the Bureau of Motor Vehicles will determine from the best evidence available whether the party requesting the hearing in the opinion of the Commissioner or his duly authorized hearing officer could reasonably be considered at fault in the accident.

(d) Based upon this determination, only the party(s) determined to be at fault shall be required to provide proof of financial responsibility.

140 IND. AD. CODE § 1-3-1(4) (1979).

[6]The most common minimum statutory requirements presently in force are $15,000 for bodily injury to, or death of, one person and $30,000 per accident. In addition, Indiana requires $10,000 minimum "coverage" for property damage ($15,000/$30,000/$10,000). *See* note 4 *supra*. The Indiana Financial Responsibility Act originally established limits of $5,000/$10,000/$1,000. Ch. 159, § 14, 1947 Ind. Acts 491. In 1957, the minimums were increased to $10,000/$20,000/$5,000. Ch. 140, § 2, 1957 Ind. Acts 291. In 1971, the minimums were increased to the present $15,000/$30,000/$10,000. Act of Mar. 30, 1971, Pub. L. No. 120, § 2, 1971 Ind. Acts 546.

[7]IND. CODE § 9-2-1-15 (1976).

[8]Financial responsibility laws also provided no remedy to persons involved in accidents with "hit and run" drivers, stolen automobiles, and automobiles driven without the owner's consent. *See* Comment, *supra* note 5, at 550.

[9]Plummer, *supra* note 1, at 463. Although the financial responsiblity acts and unsatisfied judgment endorsements predominated, they were not the only weapons used to battle the financially irresponsible motorist. Today's arsenal has roots going back over fifty years:

> Since 1925 there has been a constant effort by the insurance companies and the public to minimize the number of uninsured or financially irresponsible operators upon the public highways. Some of the major plans or laws that have been proposed or adopted to do this are as follows: the Massachusetts compulsory automobile liability law, the motor vehicle financial responsibility laws, the Saskatchewan Automobile Accident Insurance Act, the New Jersey Unsatisfied Claim and Judgment Fund Law, the unsatisfied judgment insurance endorsements, the uninsured motorists voluntary endorsements, the compulsory motor vehicle indemnification fund, the equal responsibility amendment, and the automobile compensation plan.

*Id.* at 459.

This coverage protected the insured when he was injured by an uninsured motorist, but a significant drawback was that the insured needed a judgment against the uninsured motorist as a condition precedent to recovery of his policy benefits.[10]

A marked improvement occurred when Uninsured Motorists [UM] coverage was introduced approximately twenty-five years ago.[11] UM coverage allowed the insured to collect his policy benefits without securing a judgment against the uninsured motorist.[12] Unfortunately, some parties insured by UM coverage soon consumed as much time litigating policy disputes against their insurers as they had previously spent obtaining judgments against financially irresponsible motorists.[13]

However, many state legislatures viewed UM coverage as the best alternative available for dealing with the uninsured motorist epidemic.[14] Beginning in 1957,[15] many states enacted statutes which required UM coverage to be included in all automobile liability policies delivered by licensed insurers.[16] Today, all fifty states statutorily mandate UM coverage.[17]

As more states required UM coverage, the insurance industry developed standard policy provisions to effectuate both uniformity

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[10]*See* A. WIDISS, *supra* note 2, § 1.9.

[11]Moser, *The Uninsured Motorist Endorsement*, 1956 INS. L.J. 719, 719. "Although the coverage in somewhat varying forms was offered by a few carriers prior to 1954, the most widely presently used form was devised for the policyholders resident in the State of New York to meet the agitation for compulsory insurance in that state." *Id.* at 719-20.

[12]A. WIDISS, *supra* note 2, § 1.8.

[13]*Id.* § 1.12.

[14]*Id.* § 1.11.

[15]New Hampshire became the first state to require UM coverage in all automobile liability policies issued in the state. *See* N.H. REV. STAT. ANN. § 268:15-a (1977).

[16]Indiana's Uninsured Motorist Coverage Act, enacted in 1967, reflects many of the statutory provisions presently in force in most states. It provides, in part:

> No automobile liability or motor vehicle liability policy or insurance insuring against loss resulting from liability imposed by law for bodily injury or death suffered by any person arising out of the ownership, maintenance or use of a motor vehicle shall be delivered or issued for delivery in this state with respect to any motor vehicle registered or principally garaged in this state, unless coverage is provided therein or supplemental thereto, in limits for bodily injury or death set forth in Acts 1947, chapter 159, sec. 14 [9-2-1-15], as amended heretofore and hereafter, under policy provisions approved by the commissioner of insurance, for the protection of persons insured thereunder who are legally entitled to recover damages from owners or operators of uninsured motor vehicles because of bodily injury, sickness or disease, including death, resulting therefrom.

IND. CODE § 27-7-5-1 (1976).

[17]Maldonado, *Requiring Underinsured Motorist Coverage in Ohio*, 6 OHIO N.U.L. REV. 534, 534 (1979).

and cost savings.[18] Most policies in circulation today contain some, if not most, of these standard provisions.[19] However, many insurers have added, deleted, and modified certain of these provisions in an attempt to limit their liability.[20] These alterations have caused a lack of uniformity among different policies and insurers which has helped to create an increase in litigation of UM coverage questions.

Much of the litigation in the first fifteen years of UM coverage concerned definitional problems, such as the meaning of "automobile"[21] and "uninsured."[22] Some of these questions are still at issue, but since the early 1970s, the bulk of UM litigation has involved the amount of coverage available and the scope of the class insured.[23] There are several reasons for this shift.

First, although insurance companies voluntarily implemented UM coverage in their standard automobile liability policies, many have concentrated their efforts in the past twenty-five years on limiting their liability through exclusionary provisions.[24] Some of these limitations have been accepted by the courts, while others continue to be the source of heated litigation.[25]

Second, the majority of state legislatures have done little to change or update their UM statutes.[26] Most UM statutes mandate that automobile liability policies contain UM coverage commensurate with the minimum liability requirements established by the financial responsibility laws.[27] However, the general wording of most UM statutes has caused courts to struggle to discern more than an amorphous legislative intent.[28]

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[18]*See* P. PRETZEL, UNINSURED MOTORIST § 15 (1972).

[19]*Id.*

[20]*See* A. WIDISS, *supra* note 2, § 2.2.

[21]*See generally* Madison County Mut. Ins. Co. v. Goodpasture, 49 Ill. 2d 555, 276 N.E.2d 289 (1971).

[22]*See generally* Knickerbocker Ins. Co. v. Faison, 22 N.Y.2d 554, 240 N.E.2d 34, 293 N.Y.S.2d 538, *cert. denied*, 393 U.S. 1055 (1968).

[23]*See generally* State Farm Mut. Auto. Ins. Co. v. Crockett, 103 Cal. App. 3d 652, 163 Cal. Rptr. 206 (1980); Fernandez v. Selected Risks Ins. Co., 82 N.J. 236, 412 A.2d 755 (1980).

[24]A. WIDISS, *supra* note 2, § 1.12.

[25]*See, e.g.*, Note, *Insurance: Validity of the Owned-but-Uninsured Motor Vehicle Exclusion Under the Uninsured Motorist Act*, 28 OKLA. L. REV. 894 (1975); Note, *Contractual Attempts to Limit Liability Under Uninsured Motorists Coverage*, 47 U. CIN. L. REV. 245 (1978).

[26]*See* note 16 *supra*. Indiana's Act has remained substantially unchanged from the version enacted in 1967.

[27]*Id.*

[28]*See* A. WIDISS, *supra* note 2, § 1.12. "[F]or the most part . . . such statutes are no more than statements that the companies shall include an uninsured motorist endorsement in all automobile liability policies issued or delivered in that state." *Id.* at 16.

Third, courts which interpret UM statutes are faced with additional conflicts between confusing insurance policy provisions and public policy.[29] In resolving these conflicts, many courts have inconsistently applied "established" rules of insurance contract construction.[30] As a result, many of these conflicts remain unresolved, and many of the resolutions remain in conflict.[31]

Finally, the insured frequently finds that these three factors have worked to his detriment because it is only *after* he is damaged by an uninsured motorist that he discovers his UM coverage does not approximate either the coverage he thought he had or the coverage necessary to satisfy his claim. As a result, his losses are undercompensated. Moreover, the number of "undercompensated insureds" is not likely to decrease in the near future, especially because under our present system of accident reparations, a small loss is likely to result in overcompensation, while a large loss will probably be undercompensated.[32]

The general inflation of the past decade has pushed the dollar value of many 1970s small losses into the large loss category for the 1980s.[33] Nonetheless, most state legislatures have not raised the minimum requirements in their financial responsibility laws to adequately offset this increase.[34]

The cloud of the uninsured motorist is inevitably in any forecast for improvement of the present system, but some of the silver lining can be restored by making some critically needed changes. This Note will examine how the undercompensated accident victim is

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[29]Frequently, a major conflict arises when the victim of a financially irresponsible motorist incurs serious injuries. Because most insurers set their UM coverage limit at the statutorily mandated minimum, an insured with more than minimum damages faces insufficient compensation. When the insurer tries to further limit the insured's recovery through exclusionary clauses, difficult questions must be resolved involving the relative bargaining position of the parties, ambiguity, and the intent of the parties.

[30]Note, *A Reasonable Approach to the Doctrine of Reasonable Expectations as Applied to Insurance Contracts*, 13 U. MICH. J.L. REF. 603 (1980).

[31]*See, e.g.*, notes 83-84 *supra* and pt. III of text.

[32]One study determined that an individual with an actual loss of $250 who files a claim for $1,000 may well receive the $1,000 in an out-of-court settlement, primarily because the actual loss added to litigation expenses would cost the insurance company more than $1,000. *See* FED. JUDICIAL CENTER, AUTOMOBILE ACCIDENT LITIGATION 7 (1970). Another study revealed that seriously injured victims with medical expenses of $5,000 or more recovered only 55 percent of their expenses, while victims with medical expenses of less than $5,000 recovered an average of 90 percent of expenses. *See* 1 U.S. DEP'T OF TRANSPORTATION, ECONOMIC CONSEQUENCES OF AUTOMOBILE ACCIDENT INJURIES 28 (1970). *See also* A. CONARD, J. MORGAN, R. PRATT, C. VOLTZ & R. BOMBAUGH, AUTOMOBILE ACCIDENT COSTS AND PAYMENTS (1964); Morris & Paul, *The Financial Impact of Automobile Accidents*, 110 U. PA. L. REV. 913 (1962).

[33]*See* P. PRETZEL, *supra* note 18, § 8.

[34]*Id. See also* note 26 *supra*.

affected by some of the significant current problems inherent in UM litigation and will suggest changes which could help improve his prospects for adequate compensation.

## II. Basic UM Coverage

Many of the currently litigated UM insurance problems are exacerbated when courts and commentators fail to focus their analyses on the basic nature of the coverage. A significant factor which has blurred this focus is that UM coverage is frequently contained as a part of, or an endorsement to, an automobile liability policy.[35] This integration has caused confusion when various policy provisions appear to apply to both coverages.[36] Therefore, UM coverage must be distinguished from liability coverage to avoid hopeless confusion in interpreting contract provisions.

### *A. Nature of UM Coverage*

UM coverage extends protection to the insured for damages caused by the negligent driving of a financially irresponsible motorist.[37] It differs from liability coverage in several respects, but perhaps the most significant is that UM coverage is direct or "first-party" coverage, because payment of the proceeds goes directly to the insured—the first party under the insurance contract.[38] Liability coverage is generally viewed as "third-party" coverage, because payment is made to the injured third party for liability incurred by the insured first party.[39] Therefore, liability coverage protects innocent third parties from the negligent driving of an insured first party, while UM coverage protects the insured first party from an uninsured third party.[40]

A second key difference is that UM coverage is "personal" to the insured, whereas liability coverage attaches to a particular insured automobile.[41] The UM endorsement protects the insured from

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[35]*See* Brin, *Reduction and Exclusion Clauses in Uninsured Motorist Coverage*, 5 St. Mary's L.J. 439 (1973).

[36]*See, e.g.*, Indiana Farmers Mut. Ins. Co. v. Speer, 407 N.E.2d 255 (Ind. Ct. App. 1980).

[37]*See* note 16 *supra*.

[38]M. Woodroof, F. Fonseca & A. Squillante, Automobile Insurance and No-Fault Law § 1:18 (1974) [hereinafter cited as Woodroof].

[39]*Id.*

[40]*Id.* § 1:19. The authors point out that liability insurance serves as "dual" protection. It protects the insured for liability he incurs through negligent driving and it protects the victims of the insured's negligent driving. However, the authors note that the widespread availability of liability coverage has caused it to be more commonly viewed as protection for the victim than for the insured. *Id.* § 1:20.

[41]*See* A. Widiss, *supra* note 2, § 2.8.

damages caused by an uninsured motorist, even when the insured is not occupying a vehicle insured under his UM policy.[42] The insured is covered when driving or riding in another automobile or even if struck while he is a pedestrian.[43]

A third distinction is that UM coverage is generally extended to any passengers in the vehicle insured under the UM policy.[44] Liability coverage is intended to cover only the negligent *operation* of an automobile by the insured or his permittee.[45]

These basic differences between liability and UM coverages also illustrate that the risk involved in insuring against a loss is vastly different under each coverage. A person representing a significant risk for liability coverage may pose an inconsequential risk for UM purposes. For example, a teenager may represent a significant liability risk as a driver, but as a passenger, his presence in an automobile struck by an uninsured motorist has small bearing on the risk assumed by UM coverage.[46]

### *B. Mandatory UM Coverage*

The intent of most state legislatures in enacting mandatory UM coverage was to insure that the victim of an accident with a financially irresponsible motorist would be placed in at least the same position by UM coverage as if the uninsured motorist had actually carried the minimum amount of liability coverage.[47] Most insurance companies have constructed their UM coverage to do exactly that—to provide the minimum coverage.[48]

UM coverage has been standardized almost from its inception.[49] A joint drafting committee consisting of representatives from the

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[42]*Id.*

[43]*Id.*

[44]*Id.* § 2.10.

[45]*See* WOODROOF, *supra* note 38, § 4:10.

[46]Because a teenage driver may be more likely to have an accident, his chances of being injured by an uninsured motorist will increase. However, UM coverage is not "no-fault" insurance because "[t]he insured seeking recovery from his own insurer must prove those same elements he would be expected to prove if the uninsured motorist were insured." P. PRETZEL, *supra* note 18, § 6 at 9. If the teenager's driving contributed to the cause of the accident, then his recovery of UM benefits would be reduced.

[47]*See* note 16 *supra.*

[48]Although some insurance companies have begun to offer UM coverage with limits higher than the statutory minimums upon the request of the insured, the vast majority of insurers automatically tender only the minimum coverage. P. PRETZEL, *supra* note 18, § 8. *See generally* Maldonado, *supra* note 17.

A few states statutorily require that insurance companies make available UM coverage up to the bodily injury limits of the policy.

[49]*See* A. WIDISS, *supra* note 2, § 2.2.

National Bureau of Casualty Underwriters and the Mutual Insurance Rating Bureau has promulgated standard provisions for UM coverage since 1956.[50] The most recent promulgation is contained in the 1966 Standard Form Uninsured Motorist Endorsement.[51] While many policies vary in minor respects from these standard provisions, the 1966 Standard Form can be used generally to illustrate the coverage contained in most automobile liability policies currently in force.

## III. Current Disputes Involving Undercompensated Insureds

Two clauses of the Standard Form UM Endorsement, the "omnibus" clause and the "other insurance" clause, have been the subject of much of the current litigation by undercompensated accident victims.[52] Courts and insureds alike have been confused by both clauses. Frequently, the judicial resolutions of this confusion have also been in conflict.[53]

### *A. "Other Insurance" and the Stacking Issue*

The Standard Form contains a clause which has been labeled the "other insurance" clause.[54] Its purpose is to limit the insurer's liability in cases where the insured has more than one source of insurance compensation available. This "multiple coverage" situation stimulates questions concerning the insured's ability to "stack" the coverages of more than one UM endorsement. Often, the validity of an "other insurance" clause is key to determining whether stacking will be allowed.[55]

*1. The "Stacking" Concept.*—"Stacking" of UM coverage involves the accumulation of benefits which are supplied by more than one UM endorsement, thereby increasing the total amount which the injured insured can recover.[56] The availability of this increased recovery is placed at issue when an individual has damages which exceed the coverage limits contained in one UM endorsement.[57]

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[50]*Id.*

[51]Standard Coverage Part, Protection Against Uninsured Motorists (1966) [hereinafter cited as 1966 Standard Form]. For the complete text of the 1966 Standard Form and its predecessors, *see* A. Widiss, *supra* note 2, at 291 app. A, 1.

[52]*See* note 62 *infra*.

[53]*See* notes 61-62 *infra* and accompanying text.

[54]*See* 1966 Standard Form, *supra* note 51, pt. VI. E.

[55]*See* P. Pretzel, *supra* note 18, § 25.5 (B).

[56]*Id.*

[57]The insured can exceed the coverage limits of one UM endorsement without suffering extensive injuries. For example, if five occupants in a vehicle struck by an

These additional UM coverages become available in three basic situations.

First, X should have UM coverage under the liability policy which covers an automobile he owns.[58] Additionally, many of the non-owned vehicles in which X rides will also have UM protection for passengers.[59] If X is injured by an uninsured motorist while riding in such a non-owned vehicle, he will qualify as an "insured" under both of these UM coverages. If X's damages exceed the UM limit of the policy covering the non-owned vehicle, he will probably seek additional compensation under his own UM policy. Thus, X will try to stack the UM benefits of his own policy on top of the non-owned policy benefits.

Second, X may own several automobiles, with a separate liability policy for each automobile. X will be an "insured" under each policy. If X is injured by an uninsured motorist he may try to stack the UM limit in *each* owned *policy* until he is fully compensated.

Third, X may have one liability policy which covers all of his automobiles. Since each automobile will have a UM coverage limit, X may try to stack the UM limit for *each* owned *automobile* to increase his recovery.

*2. Judicial Reaction to Stacking.*—Courts have confronted the stacking issue in a multitude of cases involving a myriad of fact situations.[60] The confusion flowing from the conflicting resolutions of

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uninsured motorist each sustain $6,000 in injuries, a $30,000 maximum recovery would be exhausted quickly.

[58]Since all fifty states require UM coverage to be issued with every automobile liability policy, X will get UM coverage when he insures his automobile for liability. *See* notes 16-17 *supra*. The only circumstance in which X would not have UM coverage would be if X bought automobile insurance in a state whose statute allowed him to reject the coverage.

[59]*See* note 44 *supra* and accompanying text.

[60]*See, e.g.*, Burke v. Aid Ins. Co., 487 F. Supp. 831 (D. Kan. 1980) (Executrixes, whose husbands were killed in a county-owned vehicle, argued that the $15,000 per person UM coverage applicable to each county-owned vehicle could be stacked forty-four times (the county's UM policy covered a total of forty-four vehicles) for a "recovery pool" of $660,000.); Goodrich v. Lumbermens Mut. Cas. Co., 423 F. Supp. 838 (D. Vt. 1976) (Daughter could stack UM coverage of her policy and her father's policy when she was injured by an uninsured motorist who drove his car into her parents' house.); State Farm Mut. Auto. Ins. Co. v. Sinacola, 385 So. 2d 115 (Fla. Dist. Ct. App. 1980) (Father and son, who were both injured while passengers in the father's car when a non-family member was driving, could stack the father's UM benefits onto the driver's UM benefits. The litigation concerning this two-car accident involved five UM policies and three insurance companies.); Briley v. Falati, 367 So. 2d 1227 (La. Ct. App. 1979) (lessee of rental car denied stacking of UM benefits applicable to all sixty-six vehicles the lessor insured under one UM policy); Linderer v. Royal Globe Ins. Co., 597 S.W.2d 656 (Mo. Ct. App. 1980) (Employee injured by uninsured motorist when driving one of 1,420 of the employee's "fleet" vehicles sought stacking of the $20,000 per acci-

these cases may be attributable to a general judicial insensitivity to the specific facts involved in each case and their relationship to the disputed policy provisions.[61]

Several commentators have analyzed these various fact situations and propounded arguments both for and against stacking of UM coverage.[62] Unfortunately, these arguments have often fallen prey to the same problems, misunderstandings, and confusion which have plagued the courts in this area. Therefore, to avoid these common pitfalls, an understanding of the policy provisions in dispute is critical.

*3. The Excess-Escape Clause.*—The "other insurance" clause is applicable to two different common situations and it is divided into two sections: (1) the "excess-escape" clause,[63] and (2) the "pro-rata" clause.[64]

The Standard Form "excess-escape" clause provides:

> With respect to bodily injury to an insured while occupying a highway vehicle not owned by the named insured, this insurance shall apply only as excess insurance over any other similar insurance available to such insured and applicable to such vehicle as primary insurance, and this insurance shall then apply only in the amount by which the limit of liability for this coverage exceeds the applicable limit of liability of such other insurance.[65]

The "excess-escape" clause is intended to apply when an insured is injured while occupying a non-owned vehicle.[66] If this non-owned automobile has UM coverage, then the insured can only recover under his own UM coverage to the extent that its benefits exceed those supplied by the "primary policy"—the policy which covers the non-owned vehicle.[67]

For example, if A is injured while riding in a non-owned vehicle and his host, B, has a policy providing $15,000 in UM coverage, then

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dent UM coverage applicable to each company car under the employee's "fleet" UM policy. In denying stacking, the court noted that the insurer would face potential liability of $20,164,000,000 under the employee's argument.).

[61]*See* East, *Pyramiding of Uninsured Motorist Protection: The Confusion Inherent in Overgeneralization*, 5 ST. MARY'S L.J. 568 (1973).

[62]*See generally* Davis, *Uninsured Motorist Coverage: Some Significant Problems and Developments*, 42 MO. L. REV. 1 (1977); East, *supra* note 61; Note, *Stacking of Uninsured Motorist and Medical Expense Insurance Coverages in Automobile Insurance Policies*, 13 GA. L. REV. 1014 (1979).

[63]*See* 1966 STANDARD FORM, *supra* note 51, pt. VI. E.

[64]*See id.*

[65]*Id.*

[66]*See* A. WIDISS, *supra* note 2, § 2.60.

[67]*Id.*

if A's UM policy limit is also $15,000, the "excess-escape" clause limits A's total recovery to the $15,000 limit of the primary insurance. A's insurer thereby "escapes" liability. If A's UM policy limit is $20,000, then A could recover a maximum of $5,000—the "excess" over B's policy limit—under his own policy.

Most courts have refused to enforce the "excess-escape" clause for three fundamental reasons. All three were used by the court in *Simpson v. State Farm Mutual Automobile Insurance Co.*,[68] the first Indiana decision which interpreted the "excess-escape" clause.[69]

In *Simpson*, the plaintiff was a passenger in a non-owned vehicle which was struck by an uninsured motorist. The host's insurer paid its full UM policy limit of $10,000 to the plaintiff, but her personal injuries exceeded $30,000. The plaintiff was also an "insured" under two separate automobile liability policies which her mother maintained with State Farm. However, State Farm denied coverage because of the "excess-escape" clause in each of the policies. Subsequently, the plaintiff sued to recover each of the $10,000 UM limits in the State Farm policies. In rejecting State Farm's request to enforce the "excess-escape" clause, the federal district court held:

> (1) Nowhere in any of the statutes . . . does the legislature attempt to fix any maximum limit of recovery; such statutes merely fix minimum requirements. (2) Since the statutes simply provide that each policy of insurance issued must contain uninsured motorist protection in minimum amounts . . . , it follows that any attempt on the part of an insurer to limit the effect of such clauses must be in derogation of the statute. (3) The premium paid with respect to each policy of insurance necessarily includes an amount in payment of the uninsured motorist coverage; it would be unconscionable to permit insurers to collect a premium for a coverage which they are required by statute to provide, and then to avoid payment of a loss because of language of limitation devised by themselves.[70]

As a result, the plaintiff was allowed to stack the UM coverages of the two State Farm policies.

The only other Indiana case which contained an "excess-escape" clause question was *Patton v. Safeco Insurance Co. of America*.[71]

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[68]318 F. Supp. 1152 (S.D. Ind. 1970).

[69]The "excess-escape" clause in *Simpson* was very similar to the Standard Form. *See* notes 65-67 *supra* and accompanying text.

[70]318 F. Supp. at 1156.

[71]148 Ind. App. 548, 267 N.E.2d 859 (1971).

The Pattons were injured by an uninsured motorist while they were riding in a non-owned automobile. The host's insurer paid benefits under its UM policy, but, as in *Simpson*, these benefits were insufficient to cover the Pattons' injuries. Safeco also provided UM coverage through a policy which was issued on the Pattons' family car, but Safeco claim that the "excess-escape" clause in that policy negated its liability.

The Indiana Court of Appeals disagreed. It held that Indiana's UM Coverage Act was aimed at each automobile policy and not at each "insured."[72] Therefore, the court reasoned that no legislative intent existed to support limiting the insured's recovery to one UM policy.[73] Consequently, the court voided the "excess-escape" clause and allowed the Pattons to recover from their Safeco policy.[74]

*Simpson* and *Patton* illustrate the rationales which most jurisdictions have used to allow the insured to stack UM coverages in the "non-owned" situation.[75] The decision to allow stacking is the most equitable and well-reasoned result. The insured should not be penalized for riding in another vehicle which also has UM coverage, yet this is the effect of enforcing the "excess-escape" clause. Nevertheless, one observer has argued that the UM premium charged reflects the limited coverage provided; therefore, limiting the coverage is not unconscionable.[76] This position is based on two tenuous presumptions and works a particular hardship on the undercompensated motorist.

First, it presumes that the insured was informed of this limitation by the insurer and that he knowingly accepted it. Given the confusion which UM policy provisions have caused among the nation's courts and counsel, it is unreasonable to assume that the average insured party is meaningfully aware of how the "excess-escape" clause operates.

Second, the argument presupposes that insurance companies do *in fact* charge a UM premium with the knowledge that the insured will have other insurance available to him a certain percentage of the time. This places enormous trust in actuarial skills.[77] A more

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[72]The court relied primarily on the "derogation of the statute" argument used in *Simpson*. *Id.* at 553, 267 N.E.2d at 862.

[73]*Id.* at 555, 267 N.E.2d at 864.

[74]*Id.*

[75]"[M]ost of the courts which have considered the issue for the first time during the past two years have invalidated [the excess-escape clause]." A. WIDISS, *supra* note 2, § 2.60 (Supp. 1980). About two-thirds of the thirty-plus jurisdictions which have considered the "excess-escape" limitation have refused to enforce it. *Id.*

[76]*See* Note, *Uninsured Motorists Coverage In Indiana: A Review and Proposal for Change*, 13 VAL. U.L. REV. 297, 319 (1979).

[77]Since UM coverage is personal to the insured, such a calculation would be more

reasonable presumption is that insurers account for situations in which their policy will be the only UM coverage available to the insured and charge the premium accordingly. Why then should the insurer benefit by the fortuitous circumstance of the insured's occupancy in another "covered" automobile? More significantly, why should the insured suffer? The three justifications adopted by the *Simpson* court present the best resolution of this issue.

*4. The "Pro-Rata" Clause.*—The second situation involving the "other insurance" clause is when the insured is riding in or driving a vehicle which he owns and insures. This circumstance triggers the operation of the "pro-rata" section of the "other insurance" clause.[78]

The Standard Form "pro-rata" clause provides:

> Except as provided in the [excess-escape clause], if the insured has other similar insurance available to him and applicable to the accident, the damages shall be deemed not to exceed the higher of the applicable limits of liability of this insurance and such other insurance, and the company shall not be liable for a greater proportion of any loss to which this coverage applies than the limit of liability hereunder bears to the sum of the applicable limits of liability of this insurance and such other insurance.[79]

The "pro-rata" clause is inserted to limit the carrier's liability by apportioning the insured's recovery among the policies available.[80] For example, A has separate UM policies for both of his owned automobiles with $30,000 limits in each. If A incurs $60,000 in damages, then the "pro-rata" clause will limit his recovery to $30,000, with $15,000 supplied by each policy.

Courts have been more willing to enforce the "pro-rata" clause.[81] However, they have distinguished two situations to which the clause applies, enforcing it in one while voiding it in the other. The first situation involves an insured with multiple UM policies available, for example, separate policies on several owned automobiles. In this situation, the "pro-rata" clause functions like the "excess-escape" clause because it limits the insured's liability under each policy to

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complicated than determining the probability that the insured would be riding in or driving an owned as opposed to a non-owned vehicle. It would also have to recognize the insured's potential for sustaining injury as a pedestrian and the probability that the non-owned automobile would have UM coverage applicable to the insured.

[78]*See* A. WIDISS, *supra* note 2, § 2.61.

[79]*See* 1966 STANDARD FORM, *supra* note 51, pt. VI. E.

[80]*See* A. WIDISS, *supra* note 2, § 2.61.

[81]*See, e.g.*, Westhoff v. American Interinsurance Exchange, 250 N.W.2d 404 (Iowa 1977); Pettid v. Edwards, 195 Neb. 713, 240 N.W.2d 344 (1976); American Liberty Ins. Co. v. Ranzau, 481 S.W.2d 793 (Tex. 1972).

less than the statutorily mandated amount.[82] Consequently, most courts have held the clause to be repugnant to the statutory mandate and have allowed the insured to stack his benefits in this "inter-policy" situation.[83]

The second situation concerns an insured with *one* policy which covers several owned automobiles. This "intra-policy" stacking question has generally been resolved against the insured,[84] but the judicial responses are frequently confusing. Much of this confusion may be justifiable because of the applicability of two other policy provisions: (1) the limits of liability clause,[85] and (2) the separability clause.[86]

There are several Indiana decisions which involve the intra-policy stacking issue. In *Jeffries v. Stewart*,[87] Indiana's case of first impression, the insured's son was injured while attempting to jump on a dump truck driven by an uninsured motorist. The insured had one policy which covered three different owned vehicles. The UM coverage limit was $10,000 and the son's injuries totaled $30,000. The insurer did not rely on the "pro-rata" clause to avoid stacking, rather it argued that the limits of liability clause resolved any ambiguity in the policy.[88]

The court of appeals keyed on this ambiguity between the limits of liability clause and the separability clause.[89]

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[82]*See* A. WIDISS, *supra* note 2, § 2.61.

[83]*See, e.g.*, General Mut. Ins. Co. v. Gilmore, 294 Ala. 546, 319 So. 2d 675 (1975); Safeco Ins. Cos. v. Vetre, 174 Conn. 329, 387 A.2d 539 (1978); Barnes v. Government Emps. Ins. Co., 142 Ga. App. 377, 236 S.E.2d 9 (1977); Glidden v. Farmers Auto. Ins. Ass'n, 57 Ill. 2d 330, 312 N.E.2d 247 (1974); United Farm Bureau Mut. Ins. Co. v. Runnels, 382 N.E.2d 1015 (Ind. Ct. App. 1978).

[84]*See, e.g.*, Arminski v. United States Fidelity & Guar. Co., 23 Mich. App. 352, 178 N.W.2d 497 (1970); Allstate Ins. Co. v. McHugh, 124 N.J. Super. 105, 304 A.2d 777 (1973).

[85]*See* 1966 STANDARD FORM, *supra* note 51, pt. III(a). This clause provides:

> The limit of liability stated in the [declaration] as applicable to "each person" is the limit of the company's liability for all damages because of bodily injury sustained by one person as the result of any one accident and, subject to the above provision respecting "each person," the limit of liability stated in the [declarations] as applicable to "each accident" is the total limit of the company's liability for all damages because of bodily injury sustained by two or more persons as the result of any one accident.

*Id.*

[86]The Standard Form does not contain a separability clause. However, it is commonly worded: "When two or more automobiles are insured hereunder, the terms of this policy shall apply separately to each, but an automobile and a trailer attached thereto shall be held to be one automobile as respects limits of liability . . . ." Liddy v. Companion Ins. Co., 390 N.E.2d 1022, 1032 (Ind. Ct. App. 1979).

[87]159 Ind. App. 701, 309 N.E.2d 448 (1974).

[88]*Id.* at 705, 309 N.E.2d at 451.

[89]*Id.* at 707, 309 N.E.2d at 452. The court bypassed the opportunity to base its decision on the UM statute. *Id.* at 706, 309 N.E.2d at 452.

> [W]hen an insurance contract is ambiguous so as to be susceptible of more than one interpretation, that construction most favorable to the insured will be adopted.
>
> . . .
>
> [The] separability clause . . . effectuates a contract of insurance *separately as to each car insured*, and binds *each policy* with *all the provisions* and conditions of the single policy.[90]

The court found further justification for allowing the insured to stack his coverages because the insured had paid a separate UM premium for each of his three cars.[91] Thus, stacking was permitted and the insured avoided undercompensation.

However, *Jeffries* is the only bright spot in Indiana for the potential undercompensated motorist. Four subsequent Indiana decisions have refused to allow intra-policy stacking.[92] The two most recent cases, *Liddy v. Companion Insurance Co.*[93] and *Indiana Insurance Co. v. Ivers*,[94] held that insurers could limit their UM liability if the policy provisions were clear and unambiguous.[95]

Both courts distinguished *Jeffries* because in *Liddy* and *Ivers* the separability clause contained in each policy was made expressly inapplicable to the UM coverage.[96] In each case, the insured argued that because separate UM premiums were assigned to each insured automobile, stacking should be allowed.[97] Both courts rejected this contention because of the insurer's assumption of additional risk through the addition of more automobiles to the policy.[98] The *Ivers* court further elaborated by stating "that this underwriting fact justifies additional premium charges for the additional risk assumed by the company."[99]

Many insurance companies have removed the separability clause from their automobile policies, while others have modified it so that

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[90]*Id.* at 706-07, 309 N.E.2d at 452 (emphasis added).

[91]*Id.* at 708, 309 N.E.2d at 453.

[92]Trinity Universal Ins. Co. v. Capps, 506 F.2d 16 (7th Cir. 1974); Miller v. Hartford Accident & Indem. Co., 506 F.2d 11 (7th Cir. 1974); Indiana Ins. Co. v. Ivers, 395 N.E.2d 820 (Ind. Ct. App. 1979); Liddy v. Companion Ins. Co., 390 N.E.2d 1022 (Ind. Ct. App. 1979).

[93]390 N.E.2d 1022 (Ind. Ct. App. 1979).

[94]395 N.E.2d 820 (Ind. Ct. App. 1979).

[95]*Id.* at 825; 390 N.E.2d at 1034.

[96]395 N.E.2d at 823; 390 N.E.2d at 1034. In *Liddy*, the separability clause was applicable to "Part I, Coverages A and B of this policy, and separate automobiles under Part II of this policy." The UM coverage was "Part I, Coverage D." *Id.* at 1032-33.

[97]395 N.E.2d at 823-24; 390 N.E.2d at 1032.

[98]395 N.E.2d at 824; 390 N.E.2d at 1032.

[99]395 N.E.2d at 824.

it is expressly inapplicable to the UM coverage. Thus, the undercompensated motorist will have to find ambiguity in other provisions or attack the "additional risk" argument if he is to be adequately compensated in the intra-policy situation.

The "additional risk" rationale does contain several inconsistencies. The Indiana Court of Appeals could have distinguished *Liddy* and *Ivers* from *Jeffries* on another ground to make the "additional risk" argument more acceptable in the intra-policy situation. The victim in *Jeffries* was injured in a non-owned vehicle, while the insureds in *Liddy* and *Ivers* were both injured in owned vehicles.

This distinction is significant since the insurer covers certain "insureds" whether they are occupying an owned vehicle, a non-owned vehicle, or no vehicle at all.[100] Therefore, as to this class of "insureds," the insurer accepts no additional UM risk when more vehicles are added to the coverage.[101] The only additional risk which the insurer assumes is for those persons who become "insureds" by riding in additional insured automobiles.[102] Therefore, the "additional risk" argument does not appropriately apply to an intra-policy situation when an insured is occupying a non-owned vehicle or is a pedestrian.

Consequently, the only support for the "additional risk" theory comes from the insurer's coverage of those who become "insureds" by riding in the additional insured vehicles.[103] At least one jurist has recently contended that this position is untenable in view of modern insurance practices.[104] Frequently, the UM premium charged for adding automobiles to the original policy is substantially similar to the UM premium charged for the original vehicle.[105] Thus, the insured has little reason to believe that only "reduced" coverage is being supplied.[106]

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[100]Under the Standard Form these "insureds" are the insured and his family. They have UM coverage when occupying *any* vehicle or when struck as a pedestrian. This coverage is supplied by one policy on a single automobile.

[101]Because these "insureds" are covered all of the time already, the only way they could increase their risk for UM purposes would be to be in more than one place at the same time.

[102]Each automobile added to the UM policy increases the number of passengers who could potentially suffer injury. In addition, additional automobiles increase the potential for an accident with an uninsured motorist by increasing the exposure to traffic.

[103]*See* note 102 *supra.*

[104]*See* Menke v. Country Mut. Ins. co., 78 Ill. 2d 420, 430, 401 N.E.2d 539, 544 (1980) (Clark, J., dissenting).

[105]*See generally* Menke v. Country Mut. Ins. Co., 78 Ill. 2d 420, 401 N.E.2d 539 (1980).

[106]Justice Clark of the Supreme Court of Illinois has noted: "In my opinion, no reasonably prudent insurance consumer would expect the first $4 policy to cover his

In other instances, the UM premium is a single lump sum for all automobiles covered under the policy. Accordingly, the insured cannot determine the UM premium for each car, so he has no indication that he is getting "reduced" coverage for additional automobiles. Many courts have allowed insurers to further hide this "reduction" by stretching the meaning of "clear and unambiguous" when applied to complex UM policy provisions.[107] If courts continue to accept the additional risk argument, then they should require insurers to give clear notice of the coverage reduction to the insured.[108]

### *B. Which Definition of "Insured" Controls: Liability or UM?*

Every automobile liability policy contains a clause which has been labeled the "omnibus" clause. This clause defines those persons who are "insureds" under the liability policy. An "omnibus" clause is also commonly found in the UM section of the policy[109] and defines

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entire family in every conceivable situation and the second $4 policy to cover only those individuals who used his second (or third) car with permission." *Id.* at 431, 401 N.E.2d at 545.

[107]*See id.* at 424, 401 N.E.2d at 541. The majority opinion found no ambiguity, while Justice Clark depicted the following scenario in his dissent:

> [O]n page 3, the insured is unqualifiedly told that this policy will provide indemnification for injuries caused by uninsured motorists. On page 4, the policy purports to list "Exclusions Under Section II." The "other automobile insurance within the company" clause is not listed or explained under this heading. Also on page 4 is a heading entitled "Limits of Liability." But the exclusion relied upon is not found there either. On page 5, there is the heading "Other Insurance," but the exclusion at issue in this case is not to be found there either. I think a reasonable person would expect to find the exclusion at issue under one of these headings and would be misled if not discussed there.
>
> On page 4, however, there is the heading "Conditions Under Section II," which states only that 15 general conditions apply to this policy. I suppose the careful reader will then wade through the soporific wording of sections III and IV, find on page 9 "General Conditions," see the magic clause on page 10, remember that it applies to Section II, and conclude therefrom that his or her $4 premium purchases next to nothing. If the plaintiff wanted to discover the actual risk he was purchasing, he would have had to read page 3, which refers to page 1, read therein the definitions of "Persons Insured" and understand that people using the second or third vehicle with his permission were the only persons receiving uninsured motorist coverage under his second or third policy provisions.

*Id.* at 432-33, 401 N.E.2d at 545.

[108]An example of clear notice is, "The premium paid for uninsured motorist coverage in this policy purchases no additional insurance coverage for you and your family. It only buys coverage for people using your second (or third) vehicle with your permission." *Id.*

[109]*See* 1966 STANDARD FORM, *supra* note 51, pt. II. This clause provides coverage for:

those persons who are "insureds" under the UM provisions.[110] When the liability "omnibus" clause and the UM "omnibus" clause differ as to who is "insured," a coverage question naturally arises.

A significant conflict has recently developed among courts which have considered whether the definition of "insured" contained in the liability provisions or in the UM provisions of the policy should control.[111] As with stacking, the facts of each case must be closely examined to satisfactorily resolve the question.

Several courts have held that the legislative intent was to have all persons insured under the liability provisions of the policy afforded UM coverage.[112] These courts routinely have found that the liability definition of "insured" should control over the UM definition of "insured" when a conflict existed.[113] Therefore, one court stated: "While the statute does not specifically define 'insured' for the purposes of determining who is allowed to recover under the uninsured provision, it is our interpretation that the legislature intended persons insured under the liability policy to be those who would recover under the uninsured motorist coverage."[114]

Two recent decisions by the appellate courts of Michigan[115] and Indiana[116] have taken this language and used it to reach decisions which are clearly a step backward for the undercompensated accident victim and, it is submitted, are just as clearly wrong.

The Indiana case, *Indiana Farmers Mutual Insurance Co. v. Speer*,[117] involved a conflict between the definition of "persons insured" in the liability provisions of the policy and the UM endorsement. The plaintiff's policy provided the standard UM coverage for one of two vehicles he owned. Plaintiff's wife and daughter were occupying the other owned vehicle when they were struck by an un-

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(a) the named insured and any designated insured and, while residents of the same household, the spouse and relatives of either;
(b) any other person while occupying an insured highway vehicle; and
(c) any person, with respect to damages he is entitled to recover because of bodily injury to which this insurance applies sustained by an insured under (a) or (b) above.

*Id.* (emphasis deleted).

[110]*Id.*

[111]*See, e.g.*, Indiana Farmers Mut. Ins. Co. v. Speer, 407 N.E.2d 255 (Ind. Ct. App. 1980); Washington v. Travelers Ins. Co., 92 Mich. App. 151, 284 N.W.2d 754 (1979).

[112]*See* Vernon Fire & Cas. Ins. Co. v. American Underwriters, Inc., 171 Ind. App. 309, 356 N.E.2d 693 (1976). *See also* note 116 *infra.*

[113]*See* Vernon Fire & Cas. Ins. Co. v. American Underwriters, Inc. 171 Ind. App. 309, 313-14, 356 N.E.2d 693, 693 (1976).

[114]*Id.*

[115]Washington v. Travelers Ins. Co., 92 Mich. App. 151, 284 N.W.2d 754 (1979).

[116]Indiana Farmers Mut. Ins. Co. v. Speer, 407 N.E.2d 255 (Ind. Ct. App. 1980).

[117]*Id.* at 255.

insured motorist. The daughter was injured and his wife was killed. The trial court granted a partial summary judgment in plaintiff's favor, ruling that the UM coverage extended protection to the wife and daughter while occupying the other automobile.[118]

The insurer argued on appeal that the "owned but uninsured" exclusion applied to the wife and daughter and also that they were not insureds under the liability portion of the policy. The Indiana Court of Appeals held that the wife and daughter were not "persons insured" by the liability provisions and, as a result, the UM coverage did not extend to them.[119] The court cited cases from Michigan[120] and Alabama[121] in support of this holding.

All but one of these cases, *Washington v. Travelers Insurance Co.*,[122] fall short of providing sound authority for the *Speer* court's decision.[123] Each court cited held that UM coverage must be extended to all persons insured under the liability provisions.[124] Therefore, once a policy provides liability coverage for a class of insureds, that class cannot subsequently be *narrowed* by placing exclusionary clauses in the UM coverage.[125] In this sense, the liability "omnibus" clause does "control" over the UM "omnibus" clause. However, *Speer* and *Washington* were the only cases involving UM provisions which defined an insured class which was broader than the liability "omnibus" definition.[126]

Both courts seized upon the concept that "liability controls over UM," and then applied that reasoning to *narrow* the class of insureds in the UM definition.[127] They continued this misapplied rationale in holding that the legislative intent was to extend UM to those persons insured in the liability "omnibus" clause and therefore, UM coverage which was broader than liability coverage was adverse to the legislative intent.[128] Such reasoning effectively precludes an insured from having more people covered under his UM protection than are covered by liability provisions.

There are several reasons why these holdings are untenable.

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[118]*Id.* at 256.

[119]*Id.* at 259.

[120]Pappas v. Central Nat'l Ins. Group, 400 Mich. 475, 255 N.W.2d 629 (1977).

[121]State Farm Auto. Ins. Co. v. Reaves, 292 Ala. 218, 292 So. 2d 95 (1974); United States Fidelity & Guar. Co. v. Perry, 361 So. 2d 594 (Ala. Civ. App. 1978).

[122]92 Mich. App. 151, 284 N.W.2d 754 (1979).

[123]Only the *Washington* court was faced with a UM "omnibus" clause which was broader than the liability "omnibus" clause. *Id.* at 154, 284 N.W.2d at 756.

[124]*See* Indiana Farmers Mut. Ins. Co. v. Speer, 407 N.E.2d at 258.

[125]*Id.* at 259.

[126]*See* 407 N.E.2d at 258; 92 Mich. App. at 154, 284 N.W.2d at 756.

[127]407 N.E.2d at 258-59; 92 Mich. App. at 154, 284 N.W.2d at 755-56.

[128]*See* note 127 *supra.*

First, as several noted commentators have observed,[129] UM coverage is *separate* from liability coverage, notwithstanding that both coverages may be delineated in a single insurance policy.

> Because the purpose of the omnibus clause is to ensure that the liability coverage on the car is available to persons injured as the result of negligence attributable to drivers using the car with the owner's permission (that is, the protection of those foreign to the contractual designations of who is an "insured") it is highly illogical to apply it to define those eligible to recover under a separate contractual coverage provided by the policy.[130]

Second, many courts have reasoned that if the UM coverage meets the requirements detailed in the statute, then the insurance contract which the parties have made should not be altered.[131] Nevertheless, both the *Speer* and *Washington* courts used their statutes to narrow the coverage which was offered and paid for.[132]

A third flaw in these decisions is the use of legislative intent arguments in dealing with fact situations which are arguably outside the scope of legislative intent.[133] Most legislatures have set forth base limits for UM coverage which must be complied with.[134] Once these base limits have been provided, it is incorrect to use legislative intent to determine the existence or scope of coverage beyond the base limits. As several courts have noted, the statutes set a *minimum* to be met—they do not mandate a *maximum*.[135] Therefore, the parties should be free to contract for as broad a coverage as they mutually agree upon. To hold otherwise is to restrict all victims of uninsured motorists to the minimum recovery allowed under the statute. Such a restriction will only increase the number of undercompensated victims and the amount by which they are undercompensated.[136]

## IV. CONCLUSION

The number of undercompensated UM victims can only increase

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[129]*See* P. PRETZEL, *supra* note 18, § 43; *see also* A. WIDISS, *supra* note 2, § 2.13.

[130]Davis, *supra* note 62, at 5 n.24.

[131]*See* A. WIDISS, *supra* note 2, § 1.15.

[132]*See* note 126 *supra* and accompanying text.

[133]*See* A. WIDISS, *supra* note 2, § 3.11.

[134]*See* note 4 *supra* and accompanying text.

[135]*See* note 28 *supra*.

[136]Since there are already a significant amount of UM victims who are undercompensated, inflation is certain to add to their numbers if only the minimum coverage is available. *See* P. PRETZEL, *supra* note 18, § 34.

if the current system is not improved.[137] The responsibility for making these improvements must be shared by the courts, legislatures, and insurers.

Each court which is faced with a UM coverage question should carefully examine the specific facts involved in each case. Overgeneralizations are dangerous and have created much of the confusion which presently exists.[138] The judiciary can also motivate insurers to adequately inform insureds about coverage limitations by refusing to enforce complex and misleading policy provisions. However, courts should enforce policy language which is truly clear and unambiguous,[139] and they should refrain from judicially expanding UM coverage when the limitations are legitimate.

Most state legislatures should re-evaluate their mandatory UM statutes and financial responsibility acts to determine if changes or clarifications need to be made. For example, Indiana's Financial Responsibility Act has not been amended since 1971.[140] Because most current "undercompensated" UM cases involve damages between $30,000 and $50,000, an increase in the minimum limits could significantly reduce the number of victims who actually end up being undercompensated.

Although a few insurance companies have begun to make UM coverage available with higher limits, the vast majority continue to issue policies which provide only the statutorily mandated minimums.[141]

Automobile liability insurance is available with various limits, therefore it seems reasonable to offer the insured some choice of expanded UM coverage. This would increase the insured's knowledge of his UM coverage and would allow those insureds who prefer the minimum limits to intelligently reject additonal coverage.

Insurers should not wait for courts to force them to make policy provisions more understandable to the insured. At least one state insurance commission has strongly suggested that insurance companies take the initiative in simplifying policy language.[142] This

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[137] *Id.*

[138] *See* note 17 *supra* and accompanying text.

[139] *See* note 107 *supra.*

[140] *See* note 6 *supra.*

[141] *See* note 17 *supra.*

[142] *See* WASH. INS. COMM. BULLETIN 78-2 (1978), which provides in part:

> The purpose of this Bulletin is to state the Insurance Commissioner's Guidelines for Readable Auto Insurance Policies. Companies issuing auto insurance in this State should take note of these guidelines and make every effort to comply with them by January 1, 1979 or earlier if possible.
>
> 1. The provisions of this Bulletin apply to all policies providing Insurance on Private Passenger Type Automobiles owned or rented under a long term lease by an individual or husband and wife.

effort should be joined with increased information to the insured as to exactly what kind of coverage his premium buys.

Additionally, insurance companies should attempt to balance the needs of the individual insured against the costs saved by using standardized forms. The insured could be allowed to supplement the coverage delineated in the Standard Form without rendering the form obsolete. When Standard Form provisions meet judicial disfavor in a particular state, they should be removed from the policy forms issued in that state instead of spending useless litigation time trying to get them enforced.

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2. General Guidelines:

The automobile insurance policy is a legal document. The policy revision process must proceed with the highest degree of care and caution to maintain its legal status.

The revised policy shall be organized so the text follows logical thought patterns.

General policy provisions applicable to all or several coverages may be located in a common area separate from the other coverages.

Eliminate the nonessential provisions of the policy and simplify it whenever possible. The simplification shall be such that the text is readable and understandable by the average person buying insurance.

Clearly delineate between policy sections and columns. Provide adequate "white space" for easy reading.

Use everyday conversational language to the extent possible. Words used primarily by the insurance industry, such as "Premium," "Declarations Page," "Endorsement" and "Exclusion" should be eliminated as much as possible.

Use illustrations or graphic devices, such as color and layout to enhance the readability.

3. Specific Guidelines:

Use not less than 10 point type size. The type face may be selected by the company but its character should be easily read by the average person buying insurance.

Captions or headings shall be designed to stand out clearly and distinctly.

Use paper which permits the reader to read the front side of the page without visual interference from the print on the back and vice versa under normal reading conditions.

Technical or special words or phrases used throughout the policy may be defined once and used without further definition in the policy if they are italicized, printed in bold face type or otherwise distinguished.

Include a table of contents or a reasonable index for easy reference.

Use familiar words and simple sentences.

Use a personal style such as "his," "her," "you," and "we," "us" and "our."

4. Readability Testing:

A bona fide readability test shall be applied to each policy. The "Filing" of the form should identify the test used and specify the score or results.

5. When submitting a filing which does not fully comply with these guidelines, submit a statement listing the areas of noncompliance and the

Finally, the insured driver can only make a reasonable choice when he is adequately informed about his alternatives. The potential undercompensated victim deserves a chance to provide for "excess" losses before such possibility becomes a harsh reality. Courts, legislatures, and insurers should give him this chance.

ROBERT D. MAAS

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reasons therefor. If it is necessary to alter coverages such change must be explained in the filing. The Commissioner shall review the reasons contained in the variance statement in determining the acceptability of the filing.

6. Our goal for this Bulletin is to produce readable policies, without unwarranted expansion or contraction of policy coverage under the guise of readability.

# Beyond Enterprise Liability in DES Cases—*Sindell*

## I. Introduction

Throughout the development of tort law, the concept of causation has occupied differing levels of significance as a justification for the assessment of liability. Theories of liability have developed which have gradually expanded the continuum of possible relationships in which causation can be established.[1] In 1980, the California Supreme Court in *Sindell v. Abbott Laboratories*[2] further extended the realm of potential causal relationships. The plaintiff in *Sindell* was allegedly injured by a drug ingested by her mother and, being unable to identify the manufacturer of the drug, brought suit against several of the manufacturers.[3] Each defendant was held liable under a market share liability theory.[4] In so holding, the California Supreme Court rejected the more traditional theories of tort liability and moved one step forward on the spectrum of causal relationships.

The purpose of this Note is to explain the market share theory of liability and to discuss its potential effects on similar parties in future litigation.

## II. Historical Backgrounds of *DES*

Between the years 1947 and 1971, diethylstilbestrol (DES) was manufactured and marketed by the drug industry for the purpose of preventing miscarriages in pregnant women.[5] Diethylstilbestrol, a synthetic compound of the female hormone estrogen,[6] was first authorized on an experimental basis and with the requirement of a warning on the label by the Food and Drug Administration for prevention of miscarriages in 1947.[7] In 1952, the Food and Drug Ad-

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[1] *See generally* Hall v. E.I. DuPont de Nemours & Co., 345 F. Supp. 353 (E.D.N.Y. 1972); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960); Klemme, *The Enterprise Liability Theory of Torts*, 47 U. Colo. L. Rev. 153 (1976).

[2] 26 Cal. 3d 588, 607 P.2d 924, 163 Cal. Rptr. 132, *cert. denied*, 101 S.Ct. 268 (1980).

[3] *Id.* at 593, 607 P.2d at 925, 163 Cal. Rptr. at 133.

[4] *Id.* at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[5] *E.g.*, *id.* at 593, 607 P.2d at 925, 163 Cal. Rptr. at 133; Comment, *DES and a Proposed Theory of Enterprise Liability*, 46 Fordham L. Rev. 963, 963-64 (1978) [hereinafter cited as Fordham Comment].

[6] *E.g.*, 26 Cal. 3d at 593, 607 P.2d at 925, 163 Cal. Rptr. at 133; Affidavit of Don Carlos Hines, M.D., at 3, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981); Affidavit of A. Brian Little, M.D., at 4, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[7] 26 Cal. 3d at 593, 607 P.2d at 925, 163 Cal. Rptr. at 133.

ministration (FDA) considered DES no longer to be a "new drug,"[8] thus removing the inference that the drug was "not generally recognized as . . . safe"[9] and allowing additional producers to manufacture the drug without conducting further testing of the drug's safety.[10] In 1971, however, because of a possible connection between the ingestion of DES by pregnant women and cancerous or precancerous conditions in the daughters of these women, the FDA required drug companies to delete pregnancy uses from their product literature and labeling and to add specific warnings against the administration of estrogens to pregnant women.[11] The form of cancer linked to DES use is adenocarcinoma which manifests itself after a minimum latent period of ten to twelve years and which causes cancerous vaginal and cervical growths in women.[12]

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[8]Petition for Rehearing at 28 n.10, Sindell v. Abbott Labs., 85 Cal. App. 3d 1, 149 Cal. Rptr. 138 (1978) [hereinafter cited as *Sindell*, Petition for Rehearing].

[9]21 U.S.C. § 321(p)(1) (1976).

[10]*Sindell*, Petition for Rehearing, *supra* note 8, at 16. It is extremely difficult to determine how many drug companies actually manufactured DES or a similar generic compound. In an interview with an attorney for a drug company which has been a defendant in several DES cases, however, one list of 294 drug companies was presented. The companies were believed to have manufactured or distributed five milligrams or larger dosages of DES and related congeners at some time within a span of approximately 30 years from the early 1940's to the early 1970's.

In another DES case, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981), the affidavit of one doctor includes a list of 83 companies which had effective New Drug Applications to market DES or its congeners in 1952, a list of 118 companies which had manufactured or distributed DES or its congeners in 1952, and a list of 118 trade names for DES and its congeners. Affidavit of Jerome M. Maas, M.D., Exhibits A, B, & C, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[11]U.S. FOOD AND DRUG ADMINISTRATION, DEP'T OF HEALTH, EDUCATION, AND WELFARE, DRUG BULL., DIETHYLSTILBESTROL CONTRAINDICATED IN PREGNANCY (Nov. 1971).

[12]The leading publication is Herbst, Ulfelder and Poskanzer, *Adenocarcinoma of the Vagina*, 284 NEW ENGLAND J. OF MED. 878 (1971). The Herbst Report, however, does not show a definite causal relation between DES ingestion and adenocarcinoma in the daughters, but rather only a statistical association. Further, Dr. Herbst later reported that there are probably other factors associated with the occurrence of adenocarcinoma other than DES ingestion by the mother. Interview, *DES Update*, 30 CA-A CANCER J. FOR CLINICIANS 326, 331 (Nov./Dec. 1980).

Another condition in offspring associated with the use of DES is adenosis, a nonmalignant presence of glandular tissue in the vagina. Affidavit of Ann Brace Barnes, M.D., at 5, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981). There is evidence establishing that adenosis is not transformed into cancer and that the condition in many instances disappears spontaneously. *See, e.g.*, Ng, Reagan, Nadji, & Greenberg, *Natural History of Vaginal Adenosis in Women Exposed to Diethylstilbestrol* in Utero, 18 J. OF REPRODUCTIVE MED. 1 (1977).

Affidavits of nine distinguished physicians in *Payton v. Abbott Labs.* show that prior to the Herbst Registry in 1971 no publication was available showing any association between DES use in pregnant women and cancer in their offspring.

The litigation arising from suits brought by the injured daughters against the drug manufacturers has presented the courts with some difficult and significant issues. Because of the time span between the manufacturing, purchasing, and ingestion of the DES and the resulting injury, many women are unable to trace the drug back to its specific manufacturer.[13] Class actions against groups of the chemical corporations which manufactured DES are the result.[14]

In March of 1980, the first DES case to reach a state supreme court was decided. The case, *Sindell v. Abbott Laboratories*,[15] was a consolidation of two class actions brought against eleven drug companies as representatives of drug manufacturers which sold DES after 1941.[16] The plaintiff class represented by Sindell, the first named plaintiff, consisted of "girls and women who [were] residents of California and who [had] been exposed to DES before birth and who may or may not [have known] that fact or the dangers to which they [had been] exposed."[17] The plaintiff class represented by Rogers, the other named plaintiff, was substantially the same as that represented by Sindell,[18] but the court stated that the discussion in its opinion would apply to Rogers only if she did not succeed in establishing that one specific defendant had manufactured the DES taken by her mother.[19] Reversing the superior courts,[20] the California Supreme Court held that each defendant would be liable for the proportion of the judgment represented by its share of the DES market unless it proved that it could not have been the manufacturer of the drug which caused the plaintiff's injuries.[21]

By the time the case reached the California Supreme Court, several causes of action were alleged in the complaint. Under the first cause of action, the plaintiffs claimed that the defendants were "jointly and individually negligent in that they manufactured,

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[13]*E.g.*, Gray v. United States, 445 F. Supp. 337 (S.D. Tex. 1978); Sindell v. Abbott Labs., 26 Cal. 3d 588, 607 P.2d 924, 163 Cal. Rptr. 132, *cert. denied*, 101 S.Ct. 268 (1980); McCreery v. Eli Lilly & Co., 87 Cal. App. 3d 77, 150 Cal. Rptr. 730 (1978); Abel v. Eli Lilly & Co., 94 Mich. App. 59, 289 N.W.2d 20 (1979); Bichler v. Eli Lilly & Co., No. 15600-1974 (Sup. Ct. N.Y. 1979).

[14]*E.g.*, Gray v. United States, 445 F. Supp. 337 (S.D. Tex. 1978); Sindell v. Abbott Labs., 26 Cal. 3d 588, 607 P.2d 924, 163 Cal. Rptr. 132, *cert. denied*, 101 S.Ct. 268 (1980); McCreery v. Eli Lilly & Co., 87 Cal. App. 3d 77, 150 Cal. Rptr. 730 (1978); Abel v. Eli Lilly & Co., 94 Mich. App. 59, 289 N.W.2d 20 (1979); Bichler v. Eli Lilly & Co., No. 15600-1974 (Sup. Ct. N.Y. 1979).

[15]26 Cal. 3d 588, 607 P.2d 924, 163 Cal. Rptr. 132, *cert. denied*, 101 S.Ct. 268 (1980).

[16]*Id.* at 593 n.1, 607 P.2d at 925 n.1, 163 Cal. Rptr. at 133 n.1.

[17]*Id.*

[18]*Id.* at 596, 607 P.2d at 927, 163 Cal. Rptr. at 135.

[19]*Id.* at 597, 607 P.2d at 927, 163 Cal. Rptr. at 135.

[20]*Id.* at 613, 607 P.2d at 938, 163 Cal. Rptr. at 146.

[21]*Id.* at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

marketed, and promoted DES as a safe and efficacious drug to prevent miscarriage, without adequate testing or warning, and without monitoring or reporting its effects."[22] A second cause of action alleged that the defendants were jointly liable because they collaborated in marketing and testing the drugs and because they adhered to an industry-wide safety standard.[23] Other causes of action included strict liability, conspiracy, and violation of express and implied warranties.[24] The common factor in all of these causes of action was the allegation that each defendant acted in concert with the other defendants on the basis of express and implied agreements and in reliance on the testing and marketing methods of the other defendants.[25] The plaintiff sought $1 million in compensatory damages and $10 million in punitive damages for herself, and equitable relief for her class in the form of an order forcing the defendants to warn of the danger of DES and to establish free clinics in California to perform tests to establish the presence of the disease.[26]

## III. A Rejection of Traditional Theories

The novelty and importance of *Sindell* arises from the court's rejection of the traditional theories of tort liability in preference to a "market share" theory.[27] Before analyzing the possible effects that this new liability theory may have on similar parties in future litigation, a brief explanation of the more traditional theories is needed.[28] The court in *Sindell*, before adopting its own basis for allowing liability under the allegations of the plaintiff's complaint, discussed two more traditional theories.

The first of these is often called the alternative liability theory and is exemplified by *Summers v. Tice*.[29] The rule established in *Summers* applies when a party cannot identify which of two or more defendants caused an injury. The burden of proof of causation may then shift to the defendants to show that they were not responsible for the harm. In *Summers*, also decided by the California Supreme Court, the plaintiff had been injured when two hunters negligently shot in his direction,[30] and, as in *Sindell*, the plaintiff was unable to

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[22]*Id.* at 595, 607 P.2d at 926, 163 Cal. Rptr. at 134.

[23]*Id.*

[24]*Id.*

[25]*Id.*

[26]*Id.*

[27]*Id.* at 598, 607 P.2d at 928, 163 Cal. Rptr. at 136.

[28]For a more detailed explanation of the theories rejected by the *Sindell* court and of their applicability to DES cases, see FORDHAM Comment, *supra* note 5.

[29]33 Cal. 2d 80, 199 P.2d 1 (1948).

[30]*Id.* at 81, 199 P.2d at 2.

identify which of the defendants actually fired the injury-causing shot.[31] Both defendants were held jointly and severally liable.[32] In *Sindell*, the court stated that its reasoning in *Summers* had been based on the negligence of both defendants to the plaintiff and on the unfairness of forcing the plaintiff to isolate the defendant whose shot actually injured him.[33] Deciding that under these circumstances the defendant was in a better position to offer evidence to determine whether he or another defendant caused the injury, the *Sindell* court stated, "In these circumstance [*Summers*], we held, the burden of proof shifted to the defendants, 'each to absolve himself if he can.' "[34]

The *Sindell* court explained that the logic in *Summers* had been drawn from cases such as *Ybarra v. Spangard*,[35] in which the doctrine of res ipsa loquitur was used to imply an inference of negligence which the defendants were required to rebut.[36] In *Ybarra*, the plaintiff allegedly suffered an injury while he was unconscious during the course of surgery,[37] and again the court found that the plaintiff need not identify which defendant was responsible for the injury when the plaintiff was in no position to attain such knowledge.[38]

The defendants in *Sindell* argued that they did not have greater access than did the plaintiff to information regarding the cause of injury, but rather that the converse was true and that the *Summers* doctrine could therefore not be applied.[39] Although the language of both *Ybarra* and *Summers* implies the superior ability of the defendants to identify the specific instrumentality which injured the plaintiff, the *Sindell* court held that under *Summers* greater access by the defendants to information regarding the cause of injury was not a prerequisite to shifting the burden of proof of causation from the plaintiff to the defendant.[40] The alternative liability theory developed in *Summers*, however, was nonetheless rejected in *Sindell*.[41]

The fatal defect of the theory was the impossibility of joining all of the defendants in *Sindell*.[42] In *Summers*, there had been only two

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[31] *Id.*

[32] *Id.* at 84, 199 P.2d at 5.

[33] 26 Cal. 3d at 599, 607 P.2d at 928, 163 Cal. Rptr. at 136.

[34] *Id.* (quoting Summers v. Tice, 33 Cal. 2d at 86, 199 P.2d at 4).

[35] 25 Cal. 2d 486, 154 P.2d 687 (1944).

[36] 26 Cal. 3d at 599, 607 P.2d at 928-29, 163 Cal. Rptr. at 137.

[37] 25 Cal. 2d at 487, 154 P.2d at 688.

[38] *Id.* at 488, 154 P.2d at 690-91.

[39] *Sindell*, Petition for Rehearing, *supra* note 8, at 33-35.

[40] 26 Cal. 3d at 602, 607 P.2d at 930, 163 Cal. Rptr. at 138.

[41] *Id.*

[42] *Id.* at 602, 607 P.2d at 930-31, 163 Cal. Rptr. at 138-39.

people who were or could have been responsible for the plaintiff's injuries, and both were defendants in the lawsuit. In *Sindell*, however, there were approximately 200 drug companies which could have manufactured the drug taken by the plaintiff's mother,[43] and only five of the companies remained as defendants in the appeal.[44] The court noted that the existing *Summers* rule as embodied in the Restatement (Second) of Torts allowed the burden of proof to shift to the defendants only if the plaintiff could demonstrate that all of the defendants acted tortiously and that the harm resulted from the conduct of one of them.[45] The rule could not, therefore, fairly be applied in *Sindell* because "there [was] no rational basis upon which to infer that any defendant in this action caused plaintiff's injuries, nor even a reasonable possibility that they were responsible."[46]

The second traditional theory, the concert of action theory, applies when the defendants act pursuant to a common design to injure the plaintiff. While no express agreement among the defendants is required under this theory, at least a tacit understanding is necessary.[47] This theory of liability was also rejected in *Sindell*.[48] In defining the elements necessary to allow a recovery under concert of action, the *Sindell* court quoted section 876 of the Restatement (Second) of Torts which provides:

> For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he (a) does a tortious act in concert with the other or pursuant to a common design with him, or (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or (c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.[49]

The allegations of the complaint which charged the defendants with failure to adequately test the drug, failure to warn of its dangers, and reliance on the testing and marketing methods of the other

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[43]*Id.* at 602-03, 607 P.2d at 931, 163 Cal. Rptr. at 139.

[44]*Id.* at 596, 607 P.2d at 926, 163 Cal. Rptr. at 134. While the original complaint was against 11 drug companies, the action had been dismissed or the appeal abandoned as to the other six defendants. *Id.* at 597 n.4, 607 P.2d at 927 n.4, 163 Cal. Rptr. at 135 n.4.

[45]*Id.* at 603 n.16, 607 P.2d at 931 n.16, 163 Cal. Rptr. at 139 n.16 (construing RESTATEMENT (SECOND) OF TORTS § 433B, Comment g at 446 (1965)).

[46]26 Cal. 3d at 603, 607 P.2d at 931, 163 Cal. Rptr. at 139.

[47]W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 46, at 292 (4th ed. 1971).

[48]26 Cal. 3d at 605, 607 P.2d at 932, 163 Cal. Rptr. at 140.

[49]RESTATEMENT (SECOND) OF TORTS § 876 (1965), *quoted in* 26 Cal. 3d at 604, 607 P.2d at 932, 163 Cal. Rptr. at 140.

defendants were found insufficient to satisfy the necessary elements.[50] The court emphasized that using the experience and methods of others is a common practice in industry and that it would be unfair to find that the defendants acted in concert merely by their use of the same drug with different trade names when the formula for DES is a "scientific constant . . . and any manufacturer producing the drug must . . . utilize the formula set forth in [the United States Pharmacopoeia]. (21 U.S.C. § 351, subd. (b).)"[51]

Having rejected the two traditional theories of tort liability, the court next considered the third theory under which the plaintiff tried to recover—enterprise liability. Although generally considered to be less traditional than the alternative liability theory and the concert of action theory, enterprise liability has gained recognition as a valid theory of tort liability.[52] Enterprise liability has been defined as "the notion that losses should be borne by the doer, the enterprise, rather than distributed on the basis of fault,"[53] and thus by its definition, enterprise liability differs from the traditional tort theories based on fault.[54] This industry-wide liability theory, however, was also rejected in *Sindell*.[55] The court set forth the following reasons explaining the inapplicability of enterprise liability to the

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[50]26 Cal. 3d at 605, 607 P.2d at 932, 163 Cal. Rptr. at 140.

[51]*Id.* at 605, 607 P.2d at 933, 163 Cal. Rptr. at 142.

[52]The *Sindell* court stated that enterprise liability was "suggested in" Hall v. E.I. DuPont de Nemours & Co., 345 F. Supp. 353 (E.D.N.Y. 1972). 26 Cal. 3d at 607, 607 P.2d at 933-34, 163 Cal. Rptr. at 141-42. *Hall* was an action brought by 13 children injured by the explosions of blasting caps in 12 separate incidents in 10 different states. 345 F. Supp. at 359. In a footnote by the *Sindell* court, the choice of the phrase "was suggested" is explained as reflecing the court's uncertainty of the validity of *Hall* as authority because of a severance and transference of the plaintiffs' claims to federal court with resulting judgments based on grounds unrelated to industry-wide liability. 26 Cal. 3d at 607 n.22, 607 P.2d at 934 n.22, 163 Cal. Rptr. at 142 n.22.

However, regardless of the authoritative value of *Hall*, enterprise liability did not magically appear from one case. For excellent discussions of the development of enterprise liability, see Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L. J. 499, 500-07 (1961) [hereinafter cited as Calabresi, *Risk Distribution*] and Klemme, *supra* note 1, at 176-78.

[53]Calabresi, *Risk Distribution*, *supra* note 52, at 500.

[54]Courts have found the principles of enterprise liability inherent in cases of respondeat superior, workmen's compensation, dangerous activities, and nondelegable duties. *Hall*, 345 F. Supp. at 376-77. In these situations an employer is held vicariously liable, not because of fault but because the risks involved are broadly incidental to the enterprise undertaken. 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 26.7, at 1376 (1956). The loss falls on the manufacturer rather than on the consumer because of the responsibility which the manufacturer owes to the community. *See* W. PROSSER, *supra* note 47, § 71, at 471.

Whether this responsibility extends beyond the individual manufacturer to the industrial entity is necessarily based on a public policy decision of where the risk of loss best be laid. 345 F. Supp. at 378.

[55]26 Cal. 3d at 609, 607 P.2d at 935, 163 Cal. Rptr. at 143.

*Sindell* fact situation: (1) the large number of manufacturers of DES; (2) the lack of allegations of any trade association to which the defendants had delegated any safety functions and which would, therefore, have evidenced a joint controlling of the risk; and (3) the close regulation of testing and manufacturing of drugs by the FDA.[56]

If the court had been confined to these three theories of liability, the plaintiff's complaint in *Sindell* would not have stated a sufficient cause of action.[57] The *Sindell* court, however, reversed the lower court's judgment sustaining the defendant's demurrers and, by combining aspects of alternative liability and enterprise liability, developed a fourth theory of liability. This hybrid theory would hold each defendant liable for the proportion of the judgment represented by its share of the DES market, absent any proof by an individual defendant that it could not have manufactured the injury-causing drug.[58]

## IV. Causation Under the Market Share Liability Theory

To understand the implications of the market share theory, it must be realized that the problem presented by the DES cases is mainly one of causation. The solution reached by the court in *Sindell* attempts to reconcile the inability of innocent plaintiffs similar to Sindell to recover from anyone other than the manufacturer[59] with

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[56]*Id.* These three factors point out the differences between *Hall* and *Sindell*. In *Hall*, the court placed emphasis on the relatively small number of manufacturers in the blasting cap industry, 345 F. Supp. at 378, (as opposed to 200 manufacturers of DES); the defendants in *Hall* had delegated safety functions to a trade association, 345 F. Supp. at 367; and the blasting cap industry was not strictly regulated by an agency such as the FDA.

[57]26 Cal. 3d at 610, 607 P.2d at 936, 163 Cal. Rptr. at 144. Other DES cases which disagree with the *Sindell* court's finding of an insufficient cause of action under the three theories of liability will be discussed later. *See* note 89 *infra* and accompanying text.

[58]26 Cal. 3d at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[59]Bichler v. Eli Lilly & Co., No. 15600-1974 (Sup. Ct. N.Y. 1979) is another DES case which illustrates the difficulty of a plaintiff similarly situated to Sindell in bringing a suit against someone other than the manufacturer of the drug. The plaintiff, a woman who had taken DES during pregnancy, brought an action against a manufacturer, the doctor who prescribed the drug, and a hospital. In a second action, she also brought charges against the pharmacist who provided her with the drug. Bichler v. Willing, Index No. 7799/75. On an appeal from a denial of the pharmacist's motion for summary judgment, the claim against the pharmacist alleging negligence, strict liability, and breach of warranty was dismissed. Bichler v. Willing, 58 A.D.2d 331, 397 N.Y.S.2d 57 (1977), *appeal dismissed*, (May 12, 1978).

The claim against the hospital was heard by a medical malpractice board which unanimously found for the hospital, and the claim against the hospital was discontinued. Brief of Defendant at 6, Bichler v. Eli Lilly & Co., No. 15600-1974 (Sup. Ct. N.Y. 1979). After the case against the doctor was dismissed, only the manufacturer remained as a defendant in the final case.

the questionable justice of holding the manufacturer liable when there has been no proof of causation showing their drug to have been ingested by the plaintiff's mother. Reiterating its rejection of an unmodified *Summers* rationale, the *Sindell* court recognized that if the chance that any particular defendant produced the injury-causing drug were measured, there would be a significant possibility, perhaps even a probability, that none of the five companies named as defendants had manufactured the drug and that one of the other 200 companies not named as defendants had actually produced the injury-causing drug. The company which actually "caused" the injury would thus escape liability.[60] The court, however, chose to approach the issue of causation from a different perspective and held that it would be "reasonable . . . to measure the likelihood that any of the defendants supplied the product which allegedly injured plaintiff by the percentage which the DES sold by each of them for the purpose of preventing miscarriage bears to the entire production of the drug sold by all for that purpose."[61] This view of causation would make each manufacturer's liability "approximate its responsibility for the injuries caused by its own products."[62] The court explained this rationale as follows:

> "[I]f X Manufacturer sold one-fifth of all the DES prescribed for pregnancy and identification could be made in all cases, X would be the sole defendant in approximately one-fifth of all cases and liable for all the damages in those cases. Under alternative liability, X would be joined in all cases in which identification could not be made, but liable for only one-fifth of the total damages in these cases. X would pay the same amount either way. Although the correlation is not, in practice, perfect . . . , it is close enough so that defendants' objections on the ground of fairness lose their value."[63]

Thus, the court's analysis of causation is taken from alternative liability, but has expanded the *Summers* rule to include an entire industry, as in enterprise liability, in the range of those who may be held liable, even though all manufacturers are not joined as defendants. In discussing enterprise liability, the *Sindell* court relied heavily on a law review comment[64] which suggested the application of enterprise liability to DES cases. Although the court refused to apply this doctrine as set forth in the comment and relied mainly on a

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[60]26 Cal. 3d at 611, 607 P.2d at 936-37, 163 Cal. Rptr. at 144-45.

[61]*Id.* at 611-12, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[62]*Id.* at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[63]*Id.* at 612 n.28, 607 P.2d at 937 n.28, 163 Cal. Rptr. at 145 n.28.

[64]FORDHAM Comment, *supra* note 5.

modification of the *Summers* rule, there are parallels between enterprise liability and market share liability which strongly suggest a very close correlation between the two theories.

One such parallel is the philosophy upon which the theories are based. The justification for enterprise liability, placing the losses caused to a society upon the industry which caused them, was perhaps most competently stated by Guido Calabresi, and Calabresi's justification was perhaps most coherently paraphrased by Howard Klemme.[65] Klemme stated that:

> [R]ecognizing at any one point in time that the total resources available to a society are limited, the "best" way for the members of a community to decide collectively how they want those limited resources to be used and distributed in order to satisfy most efficiently the greatest possible number of the members' individual wants and desires is through an open, competitive market system. The various competing uses to which the community's limited resources might be allocated in order to satisfy the maximum possible individual wants and desires will accordingly be determined through operation of the laws of supply and demand.[66]

Enterprise liability uses the marketplace as a tool not only for the original allocation of resources but also for the distribution of losses on a resource allocation theory. The loss distribution theory based on resource allocation requires two things: (1) that the cost of injuries should be borne by the activities which caused them, because the injury, regardless of fault, is a cost of such activity; and (2) that among the several societal groups participating in an enterprise, the loss should be borne by the group most likely to cause the burden to be reflected in the price of the product sold by the enterprise.[67] This reasoning differs from the rationale behind the more traditional fault theory. Under a fault theory, damages were awarded when it was determined that the defendant's activity was of less value than the resources his activity destroyed.[68] In either case, the loss to society is not replaced by a distribution of the loss to the plaintiff or to the defendant;[69] the distinction between the theories arises from the different motives behind the loss distribution.

*Sindell* contains language suggesting aspects of both fault and

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[65]Klemme is a professor of law at the University of Colorado.

[66]Klemme, *supra* note 1, at 158-59 (footnote omitted) (citing Calabresi, *Risk Distribution*, *supra* note 52, at 500-06).

[67]Calabresi, *Risk Distribution*, *supra* note 52, at 505.

[68]Klemme, *supra* note 1, at 176.

[69]*Id.* at 161.

enterprise liability but relies mainly on the principle established in *Summers*, that "as between an innocent plaintiff and negligent defendants, the latter should bear the cost of the injury."[70] The court stated that under its market share liability theory, the defendant would be held liable for approximately the same amount of losses as were actually caused by its production of DES.[71] This logic implies a fault concept; each defendant was allegedly at fault for a certain percentage of the injuries caused by the use of DES, and each manufacturer will pay this percentage. However, the court also stated that "from a broader policy standpoint,"[72] the defendants are better able to bear the cost of the injury resulting from the use of DES. Citing Justice Traynor in *Escola v. Coca Cola Bottling Co.*,[73] the court proposed that through insurance and distribution of the loss among the public as a cost of doing business, the manufacturer was better able to bear the loss.[74] This reasoning is the resource allocation and risk distribution rationale of enterprise liability, yet the court combined it with the rationale behind fault liability by attempting to hold each defendant liable for only the part of a judgment which corresponds to the percentage of all injury-causing DES production attributable to that defendant.

A second issue on which market share liability combines a fault theory of liability with enterprise liability is the degree of deterrence which a judgment allowed under each theory would produce. Proponents and opponents of enterprise liability recognize that under enterprise liability a certain degree of deterrence, or prevention of similar future losses, would normally be achieved because one of the criteria for attaching liability in enterprise liability is a consideration of whether a finding of liability would effectively increase safety incentives.[75] Opponents of enterprise liability and similar theories, however, stress that the major focus of enterprise liability is not on prevention of future losses but rather on a more appropriate application of funds available for injury compensation.[76]

Under the fault theory, it has been suggested that a system evolved which protected the integrity of an original contract between members of a society and, only incidentally, compensated the

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[70]26 Cal. 3d at 610-11, 607 P.2d at 936, 163 Cal. Rptr. at 144.

[71]*See* notes 62 & 63 *supra* and accompanying text.

[72]26 Cal. 3d at 611, 607 P.2d at 936, 163 Cal. Rptr. at 144.

[73]24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944).

[74]26 Cal. 3d at 611, 607 P.2d at 936, 163 Cal. Rptr. at 144.

[75]*See, e.g.*, Campbell, *Enterprise Liability—An Adjustment of Priorities*, 10 FORUM 1231, 1234-35 (1975); Klemme, *supra* note 1, at 176-82; O'Connell, *Expanding No-Fault Beyond Auto Insurance: Some Proposals*, 59 VA. L. REV. 749, 777-78 (1973).

[76]Campbell, *supra* note 75, at 1234-35.

victims of accidents.[77] Because no deterrence would be effected if liability was attached to a litigant for injuries which could not have been avoided, the system developed by the latter part of the nineteenth century into one which attached liability on the basis of fault.[78] Presumably, the compensation of victims, as opposed to deterrence, has now become the desired result of the system.[79] Enterprise liability, therefore, is just one more step in the evolution of the system. The emphasis has shifted from a fault limitation on liability to the best application of funds available for injury compensation.

The court in *Sindell* raised the issue of deterrence and summarily dismissed it by stating, "[t]he manufacturer is in the best position to discover and guard against defects in its products and to warn of harmful effects; thus, holding it liable for defects and failure to warn of harmful effects will provide an incentive to product safety."[80] The deterrence aspect of the court's decision focuses primarily on the superior knowledge of the defendant, or at least on the potential for superior knowledge.[81] While this emphasis appears to revert to a more traditional concept of deterrence than the compensatory aspect of enterprise liability deterrence, the court looked to the ability of the manufacturer to distribute the loss and thus again seemed to combine a fault theory with an enterprise liability theory.[82]

The court in *Sindell* found this *Summers*-type deterrence particularly applicable in a case involving medication where "the consumer is virtually helpless to protect himself" from the harm caused by a drug.[83] There are, however, many aspects of loss distribution and loss prevention in DES cases and in the application of a market share liability theory to DES litigation which are brought out in discussions of enterprise liability and which appear to indicate some startling results if the theory is widely accepted. The effects of the application of a market share theory cannot be ignored regardless of a court's nominative choice in placing the jusification for the market share liability on traditional fault theories, enterprise liability, or a new theory. It is the effect, not the choice of policy behind it, which may prove either beneficial or deleterious.

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[77]*Id.* at 1233.

[78]*Id.* at 1234 (citing Fischer, *Products Liability—The Meaning of Defect*, 39 Mo. L. Rev. 339 (1974)).

[79]Campbell, *supra* note 75, at 1234.

[80]26 Cal. 3d at 611, 607 P.2d at 936, 163 Cal. Rptr. at 144.

[81]This "superior knowledge" should not be confused with the knowledge of which manufacturer produced the injury-causing drug discussed at notes 37-40 *supra* and accompanying text.

[82]26 Cal. 3d at 611, 607 P.2d at 936, 163 Cal. Rptr. at 144.

[83]*Id.*

## V. Possible Effects of the Acceptance of the Market Share Theory in *DES* Cases

### *A. Effects on Procedure*

One area in which an acceptance of the market share liability doctrine might have a significant effect is procedure. There are at least two ways in which a plaintiff may benefit procedurally from an acceptance of the market share theory—one involving summary judgment and one involving class actions. The validity of the complaints in many DES cases has been resolved on a defendant's motion for summary judgment.[84] Although the exact requirements which must be met to withstand a defendant's motion for summary judgment may vary from state to state, it is generally true, as evidenced by the Federal Rules of Civil Procedure, that if a complaint states a genuine issue as to any material fact, the motion for summary judgment must be denied.[85]

If a market share liability theory is not accepted by courts, then plaintiffs injured by their mothers' use of DES will continue to be faced with the difficult task of deciding which theory of liability should be used as a basis for their complaints. While at first it may seem that this is the same decision which is presented to the plaintiffs in any lawsuit, it must be emphasized that because courts may find that DES cases do not fit neatly into any of the existing theories of tort liability,[86] the choice of theories by DES plaintiffs may be more critical than is the normal decision.[87] If, for example, a plaintiff brings an action under a strict liability or negligence theory, believing these theories to be most applicable, but the court feels that concert of action should have been pleaded to state a sufficient cause of action, a defendant's motion for summary judgment

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[84]*E.g.*, Sindell v. Abbott Labs., 26 Cal. 3d 588, 607 P.2d 924, 163 Cal. Rptr. 132 (1980), *cert. denied*, 101 S. Ct. 286 (1980); McCreery v. Eli Lilly & Co., 87 Cal. App. 3d 77, 150 Cal. Rptr. 730 (1978); Abel v. Eli Lilly & Co., 94 Mich. App. 59, 289 N.W.2d 20 (1979).

[85]Fed. R. Civ. P. 56(c).

[86]The confusion concerning the application of traditional liability theories to DES complaints is evidenced by the resolution of *Sindell* by the California courts. The superior courts dismissed the complaints. The appellate court reversed the lower courts and allowed the complaints under either concert of action or alternative liability, Sindell v. Abbott Labs., 85 Cal. App. 3d 1, 149 Cal. Rptr. 138 (1978). The California Supreme Court rejected all of the traditional theories. 26 Cal. 3d at 610, 607 P.2d at 936, 163 Cal. Rptr. at 144.

[87]An argument exists that DES cases do indeed fit into existing theories of tort liability but fit into the pigeonhole called "plaintiff's losers." Because some courts have allowed DES actions to be brought under existing theories, the "loser" category may be inapplicable. *See generally* Abel v. Eli Lilly & Co., 94 Mich. App. 59, 289 N.W.2d 20 (1979).

may be granted based on a mistake in pleading.[88] A DES plaintiff must therefore plead every possible cause of action under which liability may be attached in order to avoid an unfavorable summary judgment. Although it may always seem to be the best policy to bring any tort suit under all possible causes of action, DES plaintiffs are disadvantaged because the defendant's actions in manufacturing DES do not fit within any of the traditional categories of liability.[89] Because the categorization of a defendant's actions into an existing theory is unclear, the plaintiff would benefit more from a chance to argue the correlation between the facts and a theory of liability than would a plaintiff in a case involving a more standardized fact/liability theory situation. A motion for summary judgment would deny the plaintiff this opportunity. Market share liability would provide the plaintiff with a cause of action on which to base her complaint without any guessing or mistakes in pleading.

A second procedural advantage of the market share liability theory gained by a plaintiff in a DES case is an increased likelihood of a class action. The main issue under market share liability, as under enterprise liability,[90] would be whether the entire drug industry had produced and marketed a dangerous and defective drug. The economies in answering this question once in a class action instead of many times in separate law suits by individual plaintiffs are obvious; conservation of judicial time and avoidance of inconsistent verdicts would be achieved.[91] To achieve these advantages, however, the plaintiff class would have to be carefully limited. Because a

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[88]This example is very similar to the result in McCreery v. Eli Lilly & Co., 87 Cal. App. 3d 77, 150 Cal. Rptr. 730 (1978). The plaintiff in *McCreery* did bring the action under strict liability and negligence theories without alleging concert of action until appeal, and the defendant's motion for summary judgment was granted. Although the court did not state that if the plaintiffs had brought the original action under concert of action, the motion would have been denied, there is language which implies at least the possibility of this result. *Id.* at 84-85, 150 Cal. Rptr. at 735.

[89]*But see* Abel v. Eli Lilly & Co., 94 Mich. App. 59, 289 N.W.2d 20 (1979). The Michigan Court of Appeals in *Abel* reversed the lower court's grant of the defendant's motion for summary judgment and held that the plaintiffs had sufficiently stated a cause of action. *Id.* at 66, 289 N.W.2d at 27.

The court specifically stated that it was not adopting a new theory of liability (including enterprise liability as a new theory) and that the only obstacle to the plaintiffs was to prove that they had suffered a certain amount of injury caused by the defendants. The apportionment of the damages was left to the defendants. *Id.* The court noted that precedent showed that the identification of the manufacturer which produced the DES taken by the plaintiff's mother was too heavy a burden to place on the plaintiff. *Id.*

[90]For a discussion of the effect of enterprise liability on DES class actions, *see* FORDHAM Comment, *supra* note 5, at 968-70 n.22.

[91]Appellant's Reply Brief at 27-28, Sindell v. Abbott Labs., 149 Cal. Rptr. 138 (1978) [hereinafter cited as *Sindell*, Reply Brief].

defendant company under market share liability could prove that it was not liable by presenting evidence proving that it did not manufacture DES at the time it was ingested by the plaintiff's mother or in the location where the plaintiff's mother received the drug,[92] conservation of judicial time and fair results would be achieved only if the plaintiff class consisted of women whose mothers had used DES in the same general time period and in the same geographical area.[93]

Further, it appears that the class action would "stand or fall with the question of joint liability of the defendant drug manufacturers."[94] In cases such as *Sindell*, where not only damages for the named plaintiffs are sought, but also equitable relief for the class through clinics established by the defendant,[95] it seems unlikely that if the plaintiff could identify one specific manufacturer, this defendant manufacturer would be burdened with the costs of establishing statewide clinics when the entire DES manufacturing industry had followed the same FDA standards and had used the same testing and marketing methods.[96] If, however, the whole industry was found to be at fault, the entire industry would presumably be responsible for performing whatever remedial action needed to be taken.[97] Thus, market share liability would be advantageous to plaintiffs by allowing them to join in one action, making the action more economically feasible to all plaintiffs, and providing relief to those plaintiffs not named but nonetheless injured, as well as by encouraging a more remedial solution as opposed to only a compensatory one.

Although the terms compensatory and remedial may seem almost synonymous in tort cases, the differentiation betweeen the words may be more than semantic.[98] If the building of clinics by defendant manufacturers is viewed as remedial, meaning that the women who will benefit from the clinics will be women who know they have been injured by the production of DES and also those women who will use the very clinics established by the defendants to determine whether they have been injured by the drug, then there appears to be more than mere compensation. The defendant

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[92]*See* note 21 *supra* and accompanying text.

[93]This was not the case in *Sindell* where the plaintiff Sindell's mother ingested the drug in Florida, and plaintiff Roger's mother took the drug in Illinois. *Sindell*, Petition for Rehearing, *supra* note 8, at 42. Had the plaintiff class been limited to plaintiffs from the same geographical area, some of the unfairness suggested by the defendants in holding them liable for a drug which may have been manufactured by a company not subject to the California court's jurisdiction would be eliminated.

[94]*Sindell*, Reply Brief, *supra* note 91, at 28.

[95]*See* note 26 *supra* and accompanying text.

[96]*Sindell*, Reply Brief, *supra* note 91, at 28.

[97]*Id.*

[98]*See generally id.* at 27.

companies will in effect be paying the costs of seeking out unknown "plaintiffs," women who may not even know themselves that they have been injured. Compensation, on the other hand, may be used to refer to the reduction of societal costs resulting from accidents.[99] Compensation in this sense connotes an attempt to reduce social dislocations resulting from an accident by "compensating" an individual for personal injury or property loss resulting from some action by another which caused the accident.[100] "The purpose of [assessing] such liability is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves."[101]

It must be remembered, however, that any loss to society will not be totally compensated, if total compensation means elimination of the loss, by placing the burden of compensation on either the plaintiff, the defendant, or anyone else.[102] A loss is just that, and the questions become who is best equipped to bear the loss and how the social dislocation of the loss can be most effectively reduced.[103]

Because the solution sought by the plaintiffs in *Sindell* asks not only for compensation for the victims known to be injured but also for remedial action for all those who may have been injured, the issue of causation becomes even more relevant. Once again, the use of the marketplace as a tool for distribution of the loss and for deterrence enters into the discussion.[104] Deterrence, the reduction of the number and severity of accidents, can be achieved by collective deterrence,[105] market deterrence,[106] or a mixed system.[107] Each type

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[99]Note, *Class Action in a Products Liability Context: The Predomination Requirement and Cause-in-Fact*, 7 HOFSTRA L. REV. 859, 867 n.48 (1979) [hereinafter cited as HOFSTRA Note] (citing G. CALABRESI, THE COSTS OF ACCIDENTS 26-27 (1970)).

[100]HOFSTRA Note, *supra* note 99, at 867.

[101]Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

[102]*See* note 69 *supra* and accompanying text.

[103]In deciding whether the consumer or the producer should bear the loss, Calabresi stated:

> Traditional tort law, even apart from the special defenses accorded to remote contractors, put the risk of loss on the victim *unless* some rather special circumstances, like injurer fault (strictly construed), existed. Today, in product liability, the risk is initially placed on the producer and remains there unless complex circumstances, more powerful than user fault, justify a shift in riskbearing from producer to user.

Calabresi, *Product Liability: Curse or Bulwark of Free Enterprise*, 27 CLEV. ST. L. REV. 313, 319 (1978) (footnote omitted). For a justification of this loss allocation, *see id.* at 319-23.

[104]*See* notes 65 & 66 *supra* and accompanying text, and note 111 *infra* and accompanying text.

[105]*See generally* G. CALABRESI, THE COSTS OF ACCIDENTS 95-113 (1970).

[106]*See generally id.* at 68-94.

[107]*See generally id.* at 113-29.

of deterrence reflects an attempt to "creat[e] incentives so that people will avoid those future injuries worth avoiding and thus achieve an optimal trade-off between safety and injury in a world where safety is not a free good, and hence injury is not a total bad."[108] Collective deterrence leaves the trade-offs to society's collective determination of which activities are to be permitted, while market deterrence allows the market to make the determination.[109] It is market deterrence which may be strengthened by allowing class actions in DES cases.

For market deterrence to be effective, the price of a particular product or activity must accurately reflect its total injury costs. Only then will the market indicate whether people are willing to pay the true cost of a product or activity or whether its cost is too high for the value placed upon it by society.[110] Permitting class actions may increase the effectiveness of market deterrence in DES cases by enabling more legitimate plaintiffs to bring claims against the drug industry through less expensive class procedures than would otherwise be possible. The price of manufacturing DES would therefore more accurately reflect the true cost of the activity. However, the issue of causation plays a vital role in the effectiveness of market deterrence. To achieve proper allocation of injury costs to a particular activity, the activity must be the cause of the injury. If there is no causal relationship between the activity and the injury, there can be no correlative trade-off between safety and injury reflected in the market price of the activity.[111]

As stated previously, the main issue in DES cases revolves around a determination of who should carry the burden of proof of causation.[112] It has been suggested that causation in the case of a defective drug is particularly compatible with class actions in that "the degree to which a contracted disease was caused by a defective drug—as opposed to other factors having nothing to do with the defective drug, *e.g.*, other drugs or poor diet—may be impossible to determine on an individual basis."[113] It was further proposed that the study of many persons over an extended period of time might provide a reliable conclusion that in each given case there would be a high degree of probability that the injury was caused by the defective drug, and that if so, individual proof of causation would be im-

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[108]Calabresi, *Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr.*, 43 U. CHI. L. REV. 69, 77 (1975) (footnote omitted).

[109]HOFSTRA Note, *supra* note 99, at 868 (citing Calabresi, *supra* note 108, at 84).

[110]Because the value placed on an activity is done ultimately by a society and not by the market, an element of collective deterrence is present in market deterrence.

[111]HOFSTRA Note, *supra* note 99, at 878.

[112]*See* notes 59-63 *supra* and accompanying text.

[113]HOFSTRA Note, *supra* note 99, at 880 (footnote omitted).

possible for the plaintiff, and the injury cost would not be allocated to the activity.[114] Thus, class actions would be more effective than individual lawsuits.

The class action may therefore seem to provide a means for a more realistic and efficient allocation of injury costs to the proper activity. However, this very difficulty confronted by individual plaintiffs in meeting the burden of proof of causation, relied on as a basis for the greater efficiency of class actions, raises the antithetical argument. For this allocation of injury costs to the defendant drug manufacturers to be proper, the defendants' activity must indeed be the cause of the injury. If there are intervening factors, having nothing to do with the nature of the drug, which make it difficult to determine the degree to which a disease was caused by the drug, then the causal link between the drug and the disease appears questionable. If the defendants' activity is not the cause of the injury, then the taxing of the manufacturers with the injury costs will cause the pricing system in the drug industry to reflect a cost which should not be placed upon it, and the market system will be distorted. The issue of causation in DES cases must therefore be closely scrutinized before the accident costs of women allegedly injured by the drug are allocated to the entire industry.

### *B. Effects Limited by Causation*

A more detailed understanding of the use of DES may help clarify the issue of causation. Before synthetic estrogens were available, natural estrogen was used to increase the level of this hormone in pregnant women to help prevent spontaneous and habitual abortion.[115] In 1947, when the synthetic estrogen compound DES became available for use as a miscarriage preventive, doctors began to

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[114] *Id.* at 880-81. Even if the burden of proof of causation could be met by an individual plaintiff, a more accurate determination of cause might be achieved by statistical proof based on a multitude of cases. *Id.* at 881.

[115] The use of estrogen to prevent miscarriages was explained as follows. The female body produces estrogen throughout life but at fluctuating levels. During pregnancy, the levels of both estrogen and progesterone begin to rise and increase continuously until a peak is reached shortly before delivery. The levels of both hormones drop precipitously immediately prior to delivery, whether delivery takes place at term or prematurely. Experimental evidence showed that the production of progestorone was dependent upon estrogen and could be regulated by estrogen administration. Estrogen could, therefore, be used to help prolong pregnancies which showed symptoms of spontaneous abortions. Affidavit of George Van Siclen Smith, M.D., at 4-6, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981). Dr. Smith is a graduate of Harvard College and Harvard Medical School, was head of the Department of Gynecology at Harvard Medical School for 20 years, was a founding member of the American College of Obstetricians and Gynecologists, and published six papers on cancer of the female genital organs. *Id.* at 1-3.

substitute the synthetic estrogen for the natural hormone in their treatment of these women, because the synthetic compound was much less expensive than natural estrogen and because of the ease with which it could be administered orally.[116] Stilbestrol, acting as an estrogen, has three effects on the pregnant woman: an increase in the circulation of the blood to the uterus, an increase in circulating estrogen, and a significant increase in the production of the natural hormone progesterone.[117]

While the fact that DES was used in women with symptoms of habitual or threatened abortion[118] tends to show that these women had problem pregnancies without any use of drugs, it has not been suggested that habitual or threatened abortion is linked causally with any form of adenosis or adenocarcinoma. Statistics, however, do indicate that many babies born of mothers who used DES would not have lived were it not for the treatment of the mothers.[119] This evidence, however, no matter how strongly it promotes the social value of DES, does not weaken the causal relationship between DES and adenocarcinoma or adenosis in the offspring. Statistics which do weaken this link are found in a comparison of the number of children with adenocarcinoma or adenosis who were daughters of women who used DES with the number of children with the diseases who were daughters of women who did not use DES. At least one study has shown the following:

> Although doctors prescribed synthetic estrogens for millions of pregnant women between the late 1940's and 1971, only 389 reported cases of clear cell adenocarcinoma have been reported in the offspring of *all* women born in the entire world during that period. Some have a drug history and some do not, but the physical appearance of the disease is the same in both groups.[120]

The studies showing no causal relation between DES and adenocarcinoma as well as those studies which do show such a relationship are not clear, concrete evidence.[121] The fact is that the ques-

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[116]Affidavit of A. Brien Little, M.D., at 4-5, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[117]*Id.*

[118]Each case would need to be examined to determine if the doctor properly prescribed estrogen. Affidavit of Ralph M. Richart, M.D., at 6-7, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[119]Affidavit of George Van Siclen Smith, M.D., at 8, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[120]Affidavit of Ralph M. Richart, M.D., at 4, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[121]The almost polar differences in the interpretations of statistical studies of DES victims are apparent from a comparison of Dixon, *Female Hormones: Hazardous*

tion of causation remains just that—a question, and even the report which first associated DES use in pregnant women with cancerous or precancerous conditions in their daughters showed only a statistical association and not a definite cause and effect relationship.[122]

The causation between DES use and adenocarcinoma in the offspring is only one of two causal connections which may be required to be shown by the plaintiff. The second causal connection is the relationship between a particular defendant and the injury to the plaintiff from DES manufactured by that particular defendant. While it is the second causal relation which is shifted from the plaintiffs to the defendants under market share liability, the first causal relation also has a significant effect on the efficacy of class actions in DES cases. Because the statistical association between maternal DES use and adenocarcinoma is not definite, other factors become significant in the case of each individual plaintiff. For example, the complete medical history of the mother, father, siblings, and other relatives, including a detailed family history of cancer, is of great relevance in determining whether the ingestion of DES by the plaintiff's mother bears any causal relation to the disease in the offspring.[123] Because the proof of this cause and effect relationship is so individualized, the support given to class actions in drug cases[124] may prove to be misplaced. While class actions would allow a study of more persons than a lawsuit with an individual plaintiff, the burden of proof of causation in the relationship between the injury and DES in general, without regard to a shifting of the burden of proof of identification of the specific manufacturer, would still need to be met on an individual basis if the industry is to be held liable only or injuries it actually caused. Only if the industry is held liable for the costs of accidents it actually caused will the market reflect a proper price determination.[125]

The second area of causation, that is, between a DES plaintiff's injury and a specific manufacturer, should be shifted to the defendants only after the first area of causation—between the plaintiff's injury and DES in general—has been proved. It is in this second area of causation that the *Sindell* court deviated from traditional tort theories. The market share liability theory of causation, which holds

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*Panacea*, 12 TRIAL MAGAZINE 21 (Oct. 1976); White, *Pregnancy Complicating Diabetes*, 7 AM. J. MED. 609 (1949) and White, *Pregnancy Complicating Diabetes*, 128 J.A.M.A. 181 (1945).

[122]*See* note 12 *supra* and accompanying text.

[123]Affidavit of Ralph M. Richart, M.D., at 6, Payton v. Abbott Labs., No. 76-1514-S (D. Mass., questions certified Jan. 15, 1981).

[124]*See* note 113 *supra* and accompanying text.

[125]*See* notes 65 & 70 *supra* and accompanying text.

each defendant to have "caused" a percentage of the injury to each specific plaintiff equal to each defendant's share of the DES market, differs from the *Summers* theory in that not all of those manufacturers who may have produced the DES ingested by the plaintiff's mother are joined as defendants,[126] and from enterprise liability in that, according to the court in *Sindell*, one manufacturer would not be responsible for the products of any or all other manufacturers, but rather would be responsible only for the damages caused by its own production of DES.[127]

Opponents of a market share liability theory have argued that allowing a cause of action in which the burden of proof of this second area of causation is shifted to the defendant is a rejection of years of tort law.[128] The applicable principles of causation in traditional tort law as stated by Dean Prosser require that, "[a]n essential element of the plaintiff's cause of action for negligence, or for that matter for any other tort, is that there be some reasonable connection between the act or omission of the defendant and the damage which the plaintiff has suffered."[129] In the context of products liability, the causation requirement has been established as follows:

> It is clear that any holding that a producer, manufacturer, seller, or a person in a similar position, is liable for injury caused by a particular product, must necessarily be predicated upon proof that the product in question was one for whose condition the defendant was in some way responsible. Thus, for example, if recovery is sought from a manufacturer, it must be shown that he actually was the manufacturer of the product which caused the injury.[130]

Although market share liability may present an extension of existing principles of causation, the expansion has a base in principles which have already been accepted such as de-emphasis on privity[131] and strict liability as applied to manufacturers without an express warranty.[132] Market share liability may, therefore, not represent a complete deviation from the more widely accepted theories of causation.

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[126]*See* notes 41-2 & 44 *supra* and accompanying text.

[127]26 Cal. 3d at 613, 607 P.2d at 938, 163 Cal. Rptr. at 146.

[128]This is the reasoning used in the *Sindell* dissent. 26 Cal. 3d at 614-16, 607 P.2d at 938-40, 163 Cal. Rptr. at 146-48 (dissenting opinion).

[129]W. PROSSER, *supra* note 47, § 41, at 236.

[130]1 F. HURSH & F. BAILEY, AMERICAN LAW OF PRODUCTS LIABILITY § 1:41, at 125 (2d ed. 1974), *cited in Sindell*, 26 Cal. 3d at 614, 607 P.2d at 938, 163 Cal. Rptr. at 146 (dissenting opinion).

[131]*See* Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).

[132]Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

Opponents of market share liability also argue that because there is no matching between plaintiffs and defendants, that is, because there is no direct cause-in-fact relation between a specific plaintiff and a particular defendant, the plaintiffs are free to "pick and choose their targets."[133] Two reasons can be given why it is unfair to target defendants: (1) because they are large companies and a plaintiff may feel there is a better chance of a higher recovery from such "deep pocket" defendants, or (2) merely because the defendant manufacturers happen to be the ones easily recognized by the plaintiff as possible manufacturers again with no proof that the manufacturers produced the injury-causing drug.[134] However, under the majority's rationale in *Sindell*, each defendant would be liable for approximately the percentage of damage for which its production of DES was responsible.[135] Thus, theoretically, even if larger manufacturers are chosen as target defendants, they will still be held liable only for the percentage of damage resulting from their production of DES.

While it may be true that "a defendant's wealth is an unreliable indicator of fault, and should play no part, at least consciously, in the legal analysis of the problem,"[136] the possible overburdening of larger manufacturers with injury costs of DES may help to offset another argument raised by opponents of market share liability.

### *C. Effects on the Drug Industry*

This second complaint of market share liability consists of a fear that a small pharmaceutical company could be charged with liability for more than its actual market share[137] and thus the potential liability of the company could then easily exceed its total sales. Presumably, the smaller company would not be able to obtain insurance and would be driven out of business.[138] If larger companies are generally chosen as target defendants, therefore, this chilling effect on smaller companies may be lessened. Problems, however, do remain. Opponents of market share liability argue that even if the target com-

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[133]26 Cal. 3d at 616, 607 P.2d at 939, 163 Cal. Rptr. at 147 (dissenting opinion).

[134]Again, this problem was suggested by the dissent in *Sindell*. 26 Cal. 3d at 618, 607 P.2d at 941, 163 Cal. Rptr. at 149.

[135]*See* note 93 *supra* and accompanying text.

[136]26 Cal. 3d at 618, 607 P.2d at 941, 163 Cal. Rptr. at 149 (dissenting opinion). For a justification of deep pocket liability, see Calabresi, *Risk Distribution*, *supra* note 52, at 527-28.

[137]Although the defendants argue that they may be held liable for the entire industry's output, their potential liability would approximate only their own percentage of the total production of DES under the market share liability theory proposed by the *Sindell* court.

[138]*Sindell*, Petition for Rehearing, *supra* note 8, at 14-17.

pany "could absorb the initial loss of a liability judgment caused by a competitor's product, it could not recoup that loss by raising the price of its own product."[139]

The defendants explain that because some drug manufacturers would not be named as target defendants, they would not be forced to bear any of the injury costs of the drug and could thus continue producing and selling DES at the regular price, while companies named as defendants would be forced to raise their prices to absorb the loss, thus making their products noncompetitive.[140] The reasoning follows that two evils would be produced: (1) "[T]he federal program of generating increased price competition by encouraging new producers or existing drugs would be seriously impeded;"[141] and (2) "the smaller companies would be driven out of the generic prescription drug business."[142]

The defendants reason that smaller companies which entered the DES market after DES was declared to be no longer a new drug and which could not afford to do the testing required of a new drug[143] would not be willing to accept potential liability for all drugs manufactured by the original manufacturers who did perform the testing.[144] These smaller companies would therefore not enter the market, resulting in fewer producers of common generic drugs and a consequent increase in the prices of all drugs due to a lack of price competition.[145] Further, if a company may be held liable for a competitor's product, the defendants argue, the unpredictability of the loss would force insurance prices to such a high level that smaller companies would not be able to afford insurance at all.[146] Without insurance, investment capital would be extremely difficult to attract, and even with the necessary investment capital, a smaller company gambling on not being chosen as a target defendant would be ruined if the gamble were lost.[147]

Although authorities were cited to support these propositions,[148] the detrimental results predicted by the defendant drug manufacturers basically remain theoretical "ifs." There is no way of knowing the actual results of an acceptance of market share liability in DES cases, and while the defendants' fears certainly have merit, there

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[139]*Id.* at 14.
[140]*Id.* at 14-15.
[141]*Id.* at 15.
[142]*Id.* at 17.
[143]*See* note 10 *supra* and accompanying text.
[144]*Sindell*, Petition for Rehearing, *supra* note 8, at 15-17.
[145]*Id.*
[146]*Id.*
[147]*Id.* at 17.
[148]*See id.* at 11-17.

are other factors which, theoretically, might offset their fears. For example, although defendants assert that some DES manufacturers, not chosen as target defendants, will escape liability and will be able to continue manufacturing DES at regular prices, it must be remembered that a market share liability theory as proposed in *Sindell* would require a "substantial" share of the entire DES market to be represented by the chosen defendants.[149] Thus, it would not be only a few manufacturers who were forced to increase their prices; rather the manufacturers not chosen as defendants would constitute the minority.

It seems very unlikely that all of the market represented by the chosen defendants, being a substantial share of the market, would suddenly shift to those companies not selected as defendants. Particularly, if it is the larger companies which will be singled out as defendants, as the defendants fear, it seems that the smaller nondefendant companies would not be able to suddenly shift gears to handle such an increased market. Carrying this line of reasoning further, if some of the market which had belonged to the larger manufacturers is shifted to the smaller companies, it appears that over a period of time, as the percentage of market owned by each manufacturer became more equalized, the manufacturers which had originally been smaller manufacturers and which had not been defendants, would now be just as attractive to plaintiffs as the other companies. As these companies increased their percentage of the market, the percentage of the market, the percentage of liability belonging to each company would increase proportionately. The result might very well be a more price-competitive drug industry.

The defendants' fears may also be mitigated when a few other basic economic considerations are applied. For example, if the target defendants are price leaders within the industry or if they are able to spread their losses over the costs of other products, the allocation to these manufacturers of accident costs from DES production may be less burdensome.[150] The degree of competition present in the industry may also play a different role in the effect of placing accident costs on the manufacturer than the defendants anticipate.

In competitive industries, an industry-wide liability would result in the following:

> substantial secondary loss spreading through wages and prices; this is true at least when accident costs vary with output or with the use of some specific resource in production. The added cost—if it is significant enough to mat-

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[149]26 Cal. 3d at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[150]*See generally* Calabresi, *Risk Distribution*, *supra* note 52, at 519-27.

> ter—results in (a) decreased output and higher prices, and (b) lower payments to, and decreased use of, those resources giving rise to the extra cost, assuming that these can be identified.[151]

In an industry involving substantial control over price and output, including monopolies, oligopolies, and price-leader industries, some of the added cost would be borne permanently by the industry in the form of decreased profits.[152] An industry-wide liability theory applied in such an industry, however, "would be unlikely to create a chronically sick industry or to concentrate losses through the elimination of firms."[153] Further, decreased profits can often be spread through decreased dividends if there are numerous firm owners.[154]

The drug industry has been considered a relatively oligopolistic industry.[155] The introduction of generic drugs in recent years, however, has allowed a greater number of capital inferior manufacturers to enter the market and to increase the price competition.[156] Therefore, because of the combined aspects of competitive and oligopolistic industries present in the drug industry, the results of a market share theory of liability may not be as extreme as the defendants fear.

Moreover, insurance may not be as difficult for smaller companies to acquire as the defendants would suggest. Even though a manufacturer will be held liable under market share liability for the results of testing performed by other manufacturers, its liability will be proportionate to its percentage of the market. The potential amount of monetary liability, therefore, is not as great as that of a larger company, and it seems logical that insurance costs for larger and smaller companies would reflect this variance in potential liability. As one further theoretical proposition, it could be argued that even if it were proportionately more difficult for a smaller manufacturer of DES to purchase insurance, this higher degree of difficulty is the same as that faced by smaller companies in any industry. If it

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[151]Calabresi, *Risk Distribution*, *supra* note 52, at 519.

[152]*Id.* at 524.

[153]*Id.*

[154]*Id.* at 526.

[155]FORDHAM Comment, *supra* note 5, at 977-78.

[156]This increased price competition arising from the use of multiple-source drugs was recognized by the Department of Health, Education, and Welfare in its 1974 discussion and adoption of maximum allowable cost regulations applicable to these multiple-source drugs. *See* 39 Fed. Reg. 40302, 40302-03 (1974); Limitations on Payment Reimbursement for Drugs, 45 C.F.R. § 19.5 (1979). *Maximum Allowable Costs for Drugs*, Office of the Secretary, Dep't of Health, Education & Welfare (July 25, 1975), *cited in Sindell*, Petition for Rehearing, *supra* note 8, at 27.

is accepted that a smaller company has less ability to spread its costs than does a larger company, then it is true for any small company in any industry, not specifically DES manufacturers.

### *D. Effects on Future Litigants*

The issues discussed above, no matter how great their merit, remain only theoretical propositions. It would be difficult indeed for a court to determine whether the market share liability theory should be accepted based on future effects on the drug industry. There are, however, problems which arise from the market share liability theory as proposed in *Sindell* which could be more easily resolved. The requirement that a "substantial" share of the market must be represented by the aggregate of the defendants is not defined.[157] The *Sindell* court cited the Fordham Comment[158] which suggested that 75% to 80% of the market be represented, but the *Sindell* court stated, "we hold only that a substantial percentage is required."[159] No further guidelines are offered.

The percentage required before a cause of action may be allowed is important in two ways: (1) to help establish a causal relationship, and (2) to ensure that each defendant is only liable for approximately his market share of the judgment. The percentage requirement is important in establishing a causal relationship because the higher the percentage of the total market represented by the defendants, the greater the chance that one of the defendants actually caused the injury. For example, if 99% of the total market is represented by the defendants, there is only a 1% chance of the true defendant escaping liability. If only 70% of the market is represented, there is a 30% chance that the injury-causing drug manufacturer will not be joined as a defendant. Representation of a greater percentage of the total market does not establish causation between any one particular defendant and the injured plaintiff. The chance, however, that *one* of the defendants actually caused the injury does increase with the higher percentage requirement of the total market, thus diminishing the chance that the injury-causing manufacturer will escape liability. Because it is the entire concept of liability, and not just an apportionment of damages, which is based on a market share theory,[160] it would seem important to reach as high a percentage of the total market as feasible to ensure as much of a causal relation as possible.

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[157]*See* 26 Cal. 3d at 612, 617, 607 P.2d at 937, 940, 163 Cal. Rptr. at 145, 148.

[158]*See* note 5 *supra*.

[159]26 Cal. 3d at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[160]*See id.* at 612, 617, 607 P.2d at 937, 940, 163 Cal. Rptr. at 145, 148.

The percentage required to constitute a substantial percentage of the market also becomes important as a result of the court's language used in defining the liability of each defendant. The court stated, "[e]ach defendant will be held liable for the proportion of the judgment presented by its share of that market . . . ."[161] This language is susceptible to two interpretations. An example may be the easiest way to explain the two possible interpretations. If 80% of the market is represented by the aggregate shares of the defendants, and if Defendant X owned 20% of the market, then under one interpretation X may be held liable for 20% of the judgment. Under this interpretation, 20% of the judgment would be left unsatisfied because 20% of the market would not be represented. Using a second interpretation, the court would say that 80% of the market would be responsible for 100% of the judgment, and using proportions, X would be liable for 25% of the judgment. Under this second analysis, the entire judgment would be allocated among the defendants, but each defendant would be held liable for a percentage of the judgment which is greater than the percentage of the market which he occupied.

Language used by the *Sindell* court, both in the majority and dissenting opinions, suggests that the second interpretation was intended.[162] Therefore, the higher the percentage of the market required to constitute a substantial share, the greater the correlation between each defendant's share of the market and its share of the judgment. Applying the reasoning of the court that each defendant "caused" a percentage of the total DES caused injuries equal to its percentage of the market, a very high correlation between the two percentages should be required.

One other question arises from the fact that only a substantial share of the manufacturers is required for a cause of action. In *Sindell*, the superior court stated that the defendants had "ignored" bringing in other manufacturers as cross-defendants.[163] Serious practical problems, however, are presented for defendants who attempt by cross-claims to bring in other manufacturers. For example, in *Rogers*, the class action consolidated with *Sindell*, the plaintiff's mother took the drug in Illinois, while in *Sindell*, the drug was prescribed and taken in Florida.[164] Some of the companies that sold DES in those states may not have sold DES in California, and may, therefore, not be subject to the jurisdiction of the California

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[161]*Id.* at 612, 607 P.2d at 937, 163 Cal. Rptr. at 145.

[162]*Id.* at 612-13, 617, 607 P.2d at 937, 940, 163 Cal. Rptr. at 145, 148.

[163]*Sindell*, Petition for Rehearing, *supra* note 8, at 42 (citing slip opinion at 29).

[164]*Sindell*, Petition for Rehearing, *supra* note 8, at 42.

courts.[165] The defendants would be hard pressed to join these other manufacturers. Also, a named defendant, if he could not even show that it was not the producer of the injury-causing drug, would certainly have a difficult task in showing enough causation relating to another manufacturer's product to bring that manufacturer in as a defendant by a cross-claim.[166] One might wonder whether a court would allow the same *Summers* theory of proof of causation among defendants as it has for the plaintiff.

### *E. Effects Peculiar to the Drug Industry*

There are other problems associated with market share liability which are more burdensome to manufacturers of prescription drugs than to the defendants in a *Summers* fact situation. These problems are based on at least two factors: (1) the large role played by the FDA in the production of the product, and (2) the social value of encouraging research and production of prescription drugs.

Prescription drugs are subject to intense scrutiny by the FDA.[167] Prescription drugs are not sold directly to the public. Rather, they are dispensed only after a doctor has examined, analyzed, and evaluated a patient.[168] Moreover, a manufacturer of a prescription drug must give an adequate warning to the physician, not to the patient, of the risks of a drug.[169] Beyond its role in categorizing drugs as "new drugs," the FDA also often dictates the language of the warnings based on information submitted by the various manufacturers, data collected from independent clinical researchers, and risks revealed by its own review of the medical literature.[170] Prescription drug cases, therefore, differ greatly from the situation found in *Summers*. The actions of the hunters in *Summers* were not regulated by any governmental agency, and the negligence of the hunters was much more attributable to their own actions and judgments than is that of a manufacturer of a prescription drug who follows FDA requirements.[171] The injuries caused by DES are,

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[165]*See* 26 Cal. 3d at 617, 607 P.2d at 940, 163 Cal. Rptr. at 148 (Richardson, J., dissenting); *Sindell*, Petition for Rehearing, *supra* note 8, at 42-43.

[166]*Sindell*, Petition for Rehearing, *supra* note 8, at 43.

[167]*See* 21 U.S.C. §§ 351-360 (1976 & Supp. III 1979).

[168]*Id.*

[169]Carmichael v. Reitz, 17 Cal. App. 3d 958, 989, 95 Cal. Rptr. 381, 400 (1971). In addition, the risks that are well known to the medical profession need not be included in the warnings. RESTATEMENT (SECOND) OF TORTS § 402A, Comment j (1965).

[170]Comment, *Package Inserts for Prescription Drugs as Evidence in Medical Malpractice Suits*, 44 U. CHI. L. REV. 398, 410 n.56, 413 (1977). *See, e.g.*, Chambers v. G. D. Searle & Co., 441 F. Supp. 377, 383 (D. Md. 1975); FDA Applicability of Drug Efficacy Study Implementation, 21 C.F.R. § 310.6 (1980).

[171]This reasoning applies, of course, only if the manufacturers have indeed complied with all of the FDA standards.

therefore, perhaps not "obviously the result of *some one's* negligence,"[172] and more specifically, not the result of the defendant's negligence. The reliance placed on FDA standards by the drug manufacturers removes a DES case one step further from the reasoning in *Summers* that as between an innocent plaintiff and negligent defendants, the latter should bear the cost of the injury.[173]

The second factor, the social utility of prescription drugs, also differentiates DES cases from *Summers*. The social utility connected with hunting must certainly balance out less than that associated with researching and manufacturing prescription drugs. This weighing is embodied in the Restatement (Second) of Torts § 402A which states:

> It is also true in particular of many new or experimental drugs as to which, because of lack of time and opportunity for sufficient medical experience, there can be no assurance of safety, . . . but such experience as there is justifies the marketing and use of the drug notwithstanding a medically recognizable risk. The seller of such products, again with the qualification that they are properly prepared and marketed, and proper warning is given, where the situation calls for it, is not to be held strictly liable for unfortunate consequences attending their use, merely because he has undertaken to supply the public with an apparently useful and desirable product, attended with a known but apparently reasonable risk.[174]

Moreover, as the dissent in *Sindell* reasoned:

> "The social and economic benefits from mobilizing the industry's resources in the war against disease and in reducing the costs of medical care are potentially enormous. The development of new drugs in the last three decades has already resulted in great social benefits. The potential gains from further advances remain large. To risk such gains is unwise. Our major objective should be to encourage a continued high level of industry investment in pharmaceutical R & D [research and development]."[175]

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[172]Ybarra v. Spangard, 25 Cal. 2d 486, 487, 154 P.2d 687, 689 (1944) (emphasis added).

[173]33 Cal. 2d at 84, 199 P.2d at 5.

[174]RESTATEMENT (SECOND) OF TORTS § 402A, Comment k (1965).

[175]26 Cal. 3d at 619, 607 P.2d at 941-42, 163 Cal. Rptr. at 149 (quoting McCreery v. Eli Lilly & Co., 87 Cal. App. 3d 77, 86-87, 150 Cal. Rptr. 730, 736 (1978) (quoting D. SCHWARTZMAN, THE EXPECTED RETURN FROM PHARMACEUTICAL RESEARCH: SOURCES OF NEW DRUGS AND THE PROFITABILITY OF R & D INVESTMENT 54 (1975).

The research and production of new drugs can be threatened by the imposition of regulations and rules of liability on prescription drug manufacturers.[176]

While the effects of these two factors would be present under any theory which places liability on the manufacturer, it becomes particularly important to be cautious in placing liability on a drug manufacturer for alleged injuries caused by a competitor's product. This caution is especially important when the causal link between DES and the plaintiff's injuries is so tenuous.

Other factors may enter into a court's acceptance or rejection of a market share liability theory.[177] However, in the final analysis the determination may simply be based upon a judicial balancing of the interests of an innocent plaintiff against the interests of a drug manufacturer who may be held liable for the injurious effects of a competitor's product which appear a generation after the product was manufactured.

## VI. CONCLUSION

The potential effects of the court's opinion in *Sindell*, both beneficial and detrimental, remain to be seen. Courts in other states may choose not to apply the California court's market share liability theory in DES cases, thus eliminating much of the controversy surrounding *Sindell*. Conversely, it may be that California, following in the tradition of *Greenman v. Yuba Power Products, Inc.*[178] and *Ybarra v. Spangard*,[179] will once again be the leading jurisdiction, pro-

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[176]W. PROSSER, *supra* note 47, § 99, at 661. One example of the deleterious effect an expansion of liability to prescription drug manufacturers may have is shown in the context of vaccines. Dr. David Sencer, then Assistant Surgeon General, indicated in January 1976, that "[m]anufacturer liability for vaccine-associated disability, regularly assigned by courts, threatens a predictable vaccine supply . . . and diminishes the chances of significant independent manufacturer-sponsored research and development of new biologics." *Hearings Before the Subcomm. on Health of the Comm. on Labor and Public Welfare*, 94th Cong. 2d Sess. 119 (Sept. 23, 1976) (Statement of Dr. David Sencer).

Further, amendments to the Food, Drug and Cosmetic Act that inhibited the introduction of new drugs by requiring more extensive proof of efficacy have cost the public more than $300 million and thousands of lives as a result of a reduced availability of those new drugs. S. PELTZMAN, REGULATION OF PHARMACEUTICAL INNOVATION: THE 1962 AMENDMENTS 1-3 (1974).

[177]One factor may arise from statutes of limitation in various states. In California a personal injury claim generally accrues, and the period of limitation commences when the wrongful act takes place. However, an exception exists when the pathological effect occurs without perceptible trauma, and the statute of limitations then begins to run only when the person knows or, by the exercise of reasonable diligence should have known, of the injury. Warrington v. Charles Pfizer & Co., 274 Cal. App. 2d 564 (1969); CAL. CIV. PROC. CODE § 29 (West 1954).

[178]59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

[179]25 Cal. 2d 486, 154 P.2d 687 (1945).

viding precedent which courts throughout the United States will follow.

Because the theory proposed in *Sindell* may become widely accepted, the decision and its possible effects should be analyzed carefully by the legal profession. This analysis is essential because of the tenuous causal relation between DES and adenocarcinoma and because shifting the burden of proof of causation from the plaintiff to the defendant, when neither party can identify the manufacturer of the injury-causing drug, may effect more than a mitigation of an insurmountable burden on the plaintiff. It may be burdening the defendant with a presumption of guilt which may in itself be insurmountable. If the California court's step forward on the spectrum of causal relationships[180] is to avoid becoming two steps backward, the market share liability theory should be applied cautiously in DES cases.

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[180]*See* note 1 *supra* and accompanying text.